

# LIMITS TO KERALA MODEL OF DEVELOPMENT

K. K. GEORGE



CENTRE FOR DEVELOPMENT STUDIES  
MONOGRAPH SERIES

# **LIMITS TO KERALA MODEL OF DEVELOPMENT**

**An Analysis of Fiscal Crisis  
and its Implications**

**K. K. George**

**CENTRE FOR DEVELOPMENT STUDIES**  
**Thiruvananthapuram**  
**1999**

### **Books by the Same Author**

- 1      Essays in Federal Financial Relations  
         (jointly with I.S.Gulati),  
         Oxford IBH and Centre for Development Studies, Delhi, 1988.
- 2      Centre - State Financial Flows and Inter-State Disparities,  
         Criterion Books, Delhi, 1988.
- 3      Economics, Development and the Quest for Alternatives (Ed)  
         Concept Publishing Company, New Delhi, 1997.

© 1993, Centre for Development Studies, Thiruvananthapuram

First published 1993

Second edition 1999

Published by the Director, Centre for Development Studies,  
Ulloor, Prasanth Nagar, Thiruvananthapuram - 695 011, Kerala

Production and Design by Tilak Baker, Centre for Development  
Studies, Ulloor, Prasanth Nagar, Thiruvananthapuram - 695 011,  
Kerala

Typeset and Printed at St. Joseph's Press  
Thiruvananthapuram -14

*For Saramma Kuriakose,  
my mother*





## **PREFACE TO THE SECOND EDITION**

I have revised the book thoroughly after updating the data upto 1997-98. The data for the nineties reflect the changes in State Finances after the economic reforms. I thank the readers for receiving the book well. The issue of sustainability of the Kerala Model raised in the book has generated public discussion in the State. I am sorry, however, that the book was misconstrued in some quarters as a critique of the Kerala model. Policy prescriptions which tend to undermine the Kerala Model were initiated avowedly based on the findings of the book. I confess that I too am a great admirer of Kerala's achievements. My only contention is that the model cannot be sustained by debt financing forever. Kerala's present crisis is nothing unique. World over, welfare states are in crisis and consequently are changing. Kerala has to change its fiscal and economic policies, taking into account changes taking place within the State and outside. This is the only way to sustain the Kerala Model of Development.

K. K. George



# CONTENTS

*Preface*

*List of Tables*

CHAPTERS	Page No.
1. Introduction	13
2. Nature and Dimensions of the Fiscal Crisis	21
3. Limits to Resource Mobilisation	34
4. Central Transfers and the Fiscal Crisis	50
5. Pattern of Kerala's Public Expenditure	68
6. Fiscal Crisis and the State's Development Crisis	102
7. Kerala Model: Fiscal Implications and Development Options	112
8. Conclusion	124





## LIST OF TABLES

1.	Table II-1	Gross Fiscal Deficit -Movement Over The Years.	28
2.	Table II-2	Comparative Position of Budgetary Surplus/Deficit of Kerala and All States.	29
3.	Table II-3	Ratio of Revenue Surplus/Deficit to Revenue Expenditure (1974-98).	30
4.	Table II-4	Ratio of Revenue Surplus/Deficit to Total Capital Receipts and Receipts in Public Accounts.	31
5.	Table II-5	Non-Plan Revenue Surplus/Deficit before and after Devolution and All Statutory Transfers.	32
6.	Table II-6	Revenue Deficit of Kerala in Plan and Non-Plan Accounts.	33
7.	Table III-1	Share of Own Funds in Financing States' Expenditure (1974-98).	43
8.	Table III-2	Ratio of Own Revenue to State Domestic Product.	44
9.	Table III-3	Per capita Own Revenue of States (1974-97).	45
10.	Table III-4	Share of Different Categories of Taxes in States' Own Tax Revenue.	46
11.	Table III-5	Share of Own Non-Tax Revenue in Total Own Revenue (1974-98).	47
12.	Table III-6	Ratio of Interest Receipts to Outstanding Loans of Kerala 1974-97).	48
13.	Table III-7	Ratio of Revenue Receipts to Revenue Expenditure (1974-98).	49
14.	Table IV-1	Share of Central Transfers in States' Expenditure.	59



15.	Table IV-2	Per capita Aggregate Central Transfers, 1956-97.	60
16.	Table IV-3	Category-Wise Per capita Central Transfers (1974-97).	61
17.	Table IV-4	Category-Wise Statutory Transfers (1974-97)	62
18.	Table IV-5	Share of Kerala in Total Upgradation Grants.	63
19.	Table IV-6	Non-Plan Revenue Surplus/ Deficit of Kerala and All States (1974-98).	64
20.	Table IV-7	Non - Plan Expenditure of Kerala under Selected Heads (1984-89).	65
21.	Table IV-8	Per capita Plan Transfers From the Centre (1974-97).	65
22.	Table IV-9	Share of Grants in Central Transfers (1974-98).	66
23.	Table IV-10	Category-Wise Discretionary Transfers (1974-97).	67
24.	Table V-1	Ratio of Expenditure to State Domestic Product.	79
25.	Table V-2	Per capita Expenditure (1974-97).	80
26.	Table V-3	Share of Social and Community Services in Total Expenditure (1974-97).	81
27.	Table V-4	Share of Different Social and Community Services in Total Expenditure	82
28.	Table V-5	Share of Education, Art, Culture and Scientific Research in Total Expenditure (1974-97).	83
29.	Table V-6	Share of Economic Services in Total Expenditure (1974-97).	84
30.	Table V-7	Share of Revenue Expenditure in Total Expenditure.	85



31.	Table V-8	Share of Revenue Expenditure (1974-97).	86
32.	Table V-9	Share of Non-Plan Expenditure in Total Expenditure.	87
33.	Table V-10	Share of Non-Plan Expenditure.	88
34.	Table V-11	Plan-Wise Share of Non- Development Expenditure.	89
35.	Table V-12	Share of Expenditure on Public Services in Total Expenditure.	90
36.	Table V-13	Per capita Revenue Expenditure on Public Services.	91
37.	Table V-14	Share of Debt Servicing in Total Expenditure.	92
38.	Table V-15	Share of Debt Servicing - Plan Wise.	93
39.	Table V-16	Ratio of Debt to State Domestic Product.	94
40.	Table V-17	State-Wise Composition of Outstanding Liabilities.	95
41.	Table V-18	Ratio of Debt Servicing Payments to Gross Loans from the Centre.	96
42.	Table V-19	Share of Pension in Revenue Expenditure - Plan -Wise.	97
43.	Table V-20	Components of Final Outlay of Kerala.	98
44.	Table V-21	Share of Consumption and Capital Formation in Final Outlay of Individual Services.	99
45.	Table V-22	Share of Compensation for Employees in Total Consumption Expenditure of Kerala.	100
46.	Table V-23	Share of Individual Services in Total Compensation for Employees in Kerala.	101
47.	Table VI-1	Annual Growth Rates in Plan Expenditure.	108

12     *Limits to Kerala Model of Development*

48.	Table VI-2	State Plan Outlays (1956-97).	109
49.	Table VI-3	Share of Central Plan Transfers in Total Plan Expenditure.	110
50.	Table VI-4	Non-Plan Revenue Surpluses under the Awards of the Finance Commissions.	111
51.	Table VII-1	Share of Individual Services in Total Consumption Expenditure of Kerala.	123

## CHAPTER I

### INTRODUCTION

The Kerala Model of Development has been attracting favourable attention, both national and international. The basic characteristic of this model of development is the high levels of social development despite low levels of per capita income. In terms of physical quality of life indicators like high literacy, high life expectancy and low infant mortality, Kerala is way ahead not only of all Indian states, but also most of the low income countries.<sup>1</sup> The Human Development Report (1992) of the United Nations Development Programme had found that Kerala is one of the two states in India which attained medium human development (the other state is Punjab). In the matter of fertility decline, Kerala witnessed the sharpest decline in South Asian region. In fact, the State seems to have reached the third stage of demographic transition characterised by low mortality rates and low fertility rates though it has not reached the high levels of per capita income, industrialisation and urbanisation usually associated with this phase of demographic transition.

One of the peculiarities of Kerala's development experience is that there is not much gender difference in social development unlike elsewhere in India. The sex ratio in Kerala is in favour of women as against the all India pattern. This ratio has been increasing in Kerala, while the same in India, as a whole, has been decreasing. In Kerala, life expectancy of women is more than that of men, unlike in India as a whole. There are very few gender differences in educational attainments. In fact, in some aspects of educational attainments, girls in Kerala are far ahead of boys. Many professions have come to be dominated by women.

Another peculiarity of Kerala experience is that there are not much rural-urban differences unlike elsewhere in India. A study, by the Central Statistical Organisation, of 22 basic facilities in Indian villages had shown that Kerala ranked first in 17 out of 22 indicators. Most of the basic facilities like roads, electricity, telephones, schools, colleges, hospitals, post offices and banks are available in villages of Kerala within 2 to 5 kilometers.<sup>2</sup>

The State was also a pioneer in introducing social security schemes. From 1981 onwards, the State is providing unemployment relief albeit at meager rates to more than 2.6 lakh unemployed. The state was the first to introduce many social security pension schemes for the benefit of its elderly people. Altogether, the State runs about 19 social welfare programs targeted mostly at the aged, the disabled and the unemployed.

In addition to this elaborate system of social security, the State also provides food security to about 97 per cent of the households, which are covered under the public distribution system for essential commodities. The coverage of public distribution system is the widest among all Indian states.

The state has also been hailed as a model for bringing down the proportion of people below the poverty line. Unlike in many other parts of India, abject poverty and destitution are not very visible in the state.

### **The Significance of Kerala Model:**

The favourable attention on the Kerala model of development has been due to a variety of reasons. According to one scholar, though Kerala cannot be copied as such, it nevertheless provides lessons that may be used to evaluate the development efforts of other societies.<sup>3</sup> The Kerala model is frequently used to support the basic need and special targeting strategy of development. According to Dreze and Sen, the success of Kerala achieving support-led security adds force to the plausibility of following this route even when the economy is poor. The fact that Kerala has achieved such success through careful



and wide coverage public support shows how much can be achieved even at a low level of income, if public action is aimed at promoting peoples' basic entitlement and capabilities.<sup>4</sup> (Dreze and Sen 1989). Kerala has also been cited sometimes to support the radical and revolutionary approach to development. It is claimed that though Kerala did not have a socialist revolution, its large well organised peasants and workers movements, provide an example of the radical revolutionary approach. Kerala also finds a place in the development debate on which is more effective; growth or redistribution? It is cited along with Sri Lanka, and Tanzania to represent the effects of redistribution while remaining broadly within the capitalist world system.<sup>5</sup> Samir Amin commends Kerala for its land reforms and the success attained in providing basic services to the people, which is "in itself a policy of redistribution of wealth and income".<sup>6</sup> Paradoxically, both Marxist writers and international development agencies including the World Bank are found to eulogise the Kerala model of development.

Reasons for the spectacular achievements of Kerala in social development are many. They are both economic and non-economic. High level of public expenditure on social services is an important economic reason. Public policy even in the early nineteenth century provided for the "state defraying the entire cost of education".<sup>7</sup> Though, the non-governmental organisations too are playing a major role in education, the state today practically underwrites the entire recurring expenditure of the institutions run by these organisations. Education at all levels has been heavily subsidised. In the health sector also, the state established an elaborate infrastructure spread throughout the state. The state had been spending nearly two fifths of its public expenditure on education, health care and other social services.

While achievements of Kerala in social development are comparable even to those of middle income countries of the world, its economic status remains low even by the standard of Indian states. Its per capita income in 1994-95 was only 83 per cent of the all India average. What is more, the relative position of its per capita income has been coming down; from 93 per cent in 1970-71 to 90 per cent in

1980-81 and again to 83 per cent in 1994-95. The distance between Kerala and Punjab, the richest state in the Indian Union has been increasing much faster. As a result, Kerala's per capita income in 1994-95 was only less than half that of Punjab. Another feature of Kerala's growth pattern is the vast differences in growth of commodity producing sectors and tertiary sector. The only sector which shows relatively high growth rates is the tertiary sector.<sup>8</sup>

Low growth in the economy is reflected in the low levels of employment. The work participation rate in Kerala in 1990-91 was only 31.4 per cent against 37.5 per cent for the country. The successive rounds of National Sample Surveys have confirmed the highest incidence of unemployment in the State.<sup>9</sup> According to the Employment Exchange statistics, there were 36.5 lakh job seekers in Kerala at the end of September 1997.<sup>10</sup> While the number of job seekers including professional and technical personnel increased by 131 percent between 1980-81 and 1990-91, the growth in employment in the organised sector was only by 12.4 per cent<sup>11</sup>.

The higher educational levels in the State have introduced a qualitative dimension to its unemployment problem. Of the total job seekers, more than three fourths were matriculates. Professional and technical personnel formed 3.6 per cent. Graduates and postgraduates formed 6.1 percent. Non matriculates formed only 23.4 percent of work seekers.<sup>12</sup> The magnitude and nature of the unemployment problem have tremendous fiscal implications. Since the problem is one of unemployment of educated manpower, some of the national schemes for unemployment reduction are not suitable for solving Kerala's peculiar unemployment problem. Besides, the capital investment required for giving employment to the educated unemployed is likely to be higher.

### **Kerala at the Cross roads**

The Kerala model is under threat now. In this monograph, we propose to examine the issue of sustainability of the model which is increasingly called into question in the wake of recurrent fiscal crisis, which is largely the result of the deceleration in state's economic

growth. The fiscal crisis is setting a limit to the state's ability to finance social expenditure as in the past. The existing Centre-State financial relationship has further impaired the state's ability to finance public expenditure. As a result, there are signs that Kerala's lead even in social services and social security is being steadily lost.

Kerala economy and society seem to have reached a cross-road not knowing whether to continue following its past model or to retrace the steps and follow the conventional paths of development followed elsewhere. For following the first option, Kerala does not have the financial resources and is not able to attract Central government funds in view of the emerging conflicts in priorities between the two arising out of the differences in the stages of human development achieved in Kerala and the rest of the country. If an altogether different path is to be followed, it may lead to the gradual erosion of its gain in social development achieved in the past.

### **Fiscal Crisis**

The government of Kerala had been running into recurrent fiscal crisis almost throughout the eighties. The problem got so aggravated during the Seventh Plan period that in December 1987, following prolongation of its overdraft beyond the mandatory seven day limit, the Reserve Bank of India suspended treasury payments on behalf of the government of Kerala. To avoid such suspensions, which imply fiscal break-downs, the state government, ever since, had been clamping down tight control on treasury payments. In fact, treasury control has almost replaced budgetary control in the State. Despite such stringent controls, treasury payments had to be suspended once again in 1992. Resort to overdrafts from the Reserve Bank of India has become a recurrent feature.

It is true that almost all states in India are saddled with fiscal crisis today.<sup>13</sup> But the frequency and magnitude of the crisis are much more in Kerala than in other states. In fact, the crisis made its appearance in Kerala in the seventies itself, much ahead of other states. These features of Kerala's fiscal crisis lead one to hypothesise whether there is any relationship between the peculiar pattern of development

followed by the State and its budgetary difficulties. The fact that the peculiar pattern of public expenditure in the state, weighed in favor of social services, had been one of the major contributory factors to the rather lopsided pattern of development, is taken cognisance of by all. However, no attempt has been made so far to understand the reverse effects, viz., the fiscal implications of the Kerala pattern of development and the State's perennial fiscal crisis. In this monograph we seek to examine whether Kerala's perennial fiscal crisis is systemic to its pattern of development. This enquiry is made in the context of our examination of the larger question of the sustainability of the Kerala Model of Development.

The present study covers the 24 year period ended in 1997-98. The study thus covers the Fifth (1974-79), Sixth (1980-85), Seventh (1985-90) and the Eighth Five Year Plan periods. The study could not be extended to earlier plan periods as the budgetary data, particularly of expenditure prior to 1974-75, are not comparable with those of the subsequent years due to changes in budgetary classification. The principal source of data has been the annual studies of state finances by the Reserve Bank of India. It may be noted that RBI's classification is somewhat different from the one used in the state budgets.

This monograph is divided into eight chapters including this introductory chapter. Chapter II traces the origin of Kerala's fiscal crisis and assesses its dimensions. Some of the peculiar features of Kerala's crisis are also identified.

Chapter III examines the issue whether it is the inadequate resource mobilisation efforts by the State or the inadequate growth of the state's economy which has contributed to its present crisis. In this context, some of the constraints in resource mobilisation posed by the Kerala pattern of development are discussed.

Chapter IV poses the question how far the inadequate appreciation of the fiscal implications of Kerala Model of Development by the Central Government had been a causative factor for Kerala's present crisis.



Chapter V examines the level and pattern of Kerala's public expenditure. The sectoral pattern of Kerala's expenditure is clearly different from that of other states although some trends towards convergence are discernible. While this pattern has contributed partly to the making of Kerala's peculiar model of development, its implications for the State's fiscal health are also serious. These implications are discussed in this chapter.

Chapter VI discusses the phenomenon of declining relative size of Kerala's State Plan outlays which further retards Kerala's economic growth.

Chapter VII discusses some of the development options now available to the State. Given the historical pattern of its development, this chapter argues for a new strategy of economic growth based on its human resources. For following such a development path, investment in education and investment in industries and agriculture are not mutually exclusive, but complementary.

Chapter VIII is the concluding chapter.

## Notes and References

1. (a) Dreze Jean and Sen Amartya, *Hunger and Public Action*, Oxford University Press 1989.
- (b) Sen Amartya, D.T.Lakdavala Memorial Lecture, Institute of Social Sciences, New Delhi 1994.
- (c) Franke, Richard and Chasin Barbara, "Kerala: Development Through Radical Reform", The Institute for Food and Development Policy, San Francisco, 1989.
- (d) Oommen, M.A. "Development Experience, Development Priorities and Fiscal Resources of Kerala," *People and Development*, Thrissur.
2. See, Oommen, op. cit.
3. Franke, op. cit.

4.      Dreze and Sen, op. cit.
5.      Franke, op. cit.
6.      Amir Samin, "Four Comments on Kerala", *Monthly Review*, New York, Jan. 1991.
7.      Quoted by World Bank, World Development Report 1991, Washington, Also, by Dreze and Sen, op. cit.
- 8      (a) Kannan K.P., "Kerala Economy at the Cross Roads?", *Economic and Political Weekly*. (EPW) Bombay Sept. 1-8, 1990.  
      (b) Kannan K.P. "Political Economy of Labor and Development in Kerala", *EPW*, Dec. 26, 1998.
9.      For latest data, See National Sample Survey, 43<sup>rd</sup> Round.
10.     Government of Kerala, *Economic Review*, 1997, Trivandrum.
11.     *Economic Review*, 1991.
12.     *Economic Review*, 1997.
13.     For details, see Government of India, Reports of the Ninth and Tenth Finance Commissions, Delhi, 1989 and 1994.

## CHAPTER II

### NATURE AND DIMENSIONS OF THE FISCAL CRISIS

In Chapter I, we had noted the role played by public expenditure in the making of the Kerala model. The State had spent heavily in the past on education, health care, public distribution system and social security. The capacity of the State to spend on these services as in the past is however getting eroded due to acute and perennial fiscal crisis. Table II-1 shows the movement of the Gross Fiscal Deficit (GFD) over recent years. The Gross Fiscal Deficits of Kerala in the nineties exceeded 20 percent of aggregate government expenditure during most of the years. In some years, the GFD came close to 25 percent of the aggregate expenditure and 7 percent of the state domestic product. The Gross Fiscal Deficits of Kerala in relation to expenditure were always larger than for All States during most years.

As noted in Chapter I, the fiscal crisis of the State government is not of recent origin, though its frequency and magnitude have increased in recent years. This may be seen from Table II-2, presenting the budgetary deficit position of Kerala with the collective position of All States from 1974-75.

The Table shows that even during the Fifth Five Year Plan period, (1974-79), Kerala had budgetary deficits during two years (1975-76 and 1976-77). The amounts involved were, however small. During the Sixth Five Year Plan period (1980-85), Kerala had deficits during four years and the amounts involved became larger. During the Seventh Plan period (1985-90), despite strict control on expenditure and treasury payments (leading to the piling up of unpaid dues to the public, government suppliers and contractors) Kerala had deficits during three out of five years. During the seven-year period (1990-1997) which coincided roughly with the post-liberalisation



period with its emphasis on containing fiscal deficits in India, the State had deficits during four years.

It is true that budgetary deficits have become a common problem for all states, right from the beginning of the Sixth Plan (1980-81).<sup>1</sup> An analysis of the deficits, however, shows some disturbing differences between Kerala and All States. Firstly, the origin of Kerala's problem dates back to the Fifth Five Year Plan period itself, as was noted earlier. Secondly, the magnitude of deficits especially revenue deficits was much larger for Kerala than for All States as may be seen from Table II-3. In many years, revenue deficits formed more than 10 per cent of the total revenue expenditure of Kerala. During most years of the eighties and the nineties, the percentage of revenue deficits of Kerala was much higher than that of All States.

While Kerala had 18 years of revenue deficits during the 24 year period ended with 1997-98, All States had revenue deficits only during 12 years. While revenue deficits became a continuous phenomenon in Kerala from 1983-84, it became a regular phenomenon for All States only from 1987-88. On the other hand, All States had capital deficits during 12 out of 24 years against 8 years for Kerala. This, implies that Kerala during many years, had been carving out surpluses in its capital account in order to finance, at least partly, its recurrent revenue deficits. In recent years, deficits of All States have also started following the Kerala pattern as they too had started giving increasing weightage to Social and Community Services.

Kerala's mounting and recurrent revenue deficits have become increasingly a charge on the States' capital receipts (See Table II.4). The pattern of financing revenue deficits with capital receipts revealed in the Table is fraught with grave consequences. The diversion of capital receipts to finance revenue expenditure naturally reduces the ability of the State to incur capital expenditure, since there is a limit to what a state government can raise by way of capital receipts. Besides, almost all capital receipts are interest bearing. The utilisation of capital receipts for current consumption is therefore bound to aggravate the debt servicing problem in future.



The State had been dipping into its Public Accounts also (Savings deposits, State Provident Funds, Insurance and Pension Funds, Reserve Funds, Welfare Funds and Deposits) to finance its revenue deficits for quite some time. In fact, during four years of the eighties, revenue deficits exceeded receipts into the government's Public Accounts. In the nineties, revenue deficits exceeded the net accretion to the State's Public Accounts during five years. It may be noted that the Public Accounts are maintained by the state governments in their fiduciary capacity, as bankers or trustees. The utilisation of these funds for current consumption, has already started impairing governments's ability to meet in time, its fiduciary obligations. It may also get the State into much more serious ways and means difficulties in future.

Within the revenue account itself, Kerala's budgetary problem has its origin in the non-plan account, unlike in the case of All States.<sup>2</sup> This may be seen from Table. II-5 which shows the non-plan revenue surplus/deficits before and after Statutory transfers effected under the aegis of the Finance Commissions.<sup>3</sup>

The Table reveals a major difference between the non-plan gap of Kerala and that of All States. After devolution of tax shares, All States had surpluses on non-plan revenue account till 1989-90. On the other hand, Kerala had non-plan deficits after devolution during the first three years of the Fifth Plan itself. Such deficits were there during all the five years of the Seventh Plan. The situation persisted during the nineties. These years of deficits for Kerala were covered by the awards of the Sixth, Eighth, Ninth and the Tenth Finance Commissions. During the first three years of Fifth Plan, grants recommended by the Sixth Finance Commission were adequate to meet Kerala's non-plan revenue gap (See col. 3). But during the Seventh Plan and the Eighth plan, even the statutory grants turned out to be totally inadequate to cover the State's non-plan gap. In fact, during this period, Kerala did not get any deficit grants at all under the substantive provision of Article 275 of the Constitution. Even after getting other non-plan, non-statutory grants<sup>4</sup> (including grants for meeting natural calamities), the State had deficits on non-plan

account during all the years of the Seventh and Eighth Plans. The above discussion points out that at least part of the present fiscal crisis of the State can be traced to the unrealistic estimation of the non-plan revenue gaps by the Eighth, Ninth and the Tenth Finance Commissions.<sup>5</sup> (See Chapter IV for details).

It may be noted that the non-plan revenue gaps calculated by us are really under estimates as compared to the gaps estimated by the Finance Commissions. The Finance Commissions' estimates of non-plan revenue are made on the basis of tax and non-tax rates prevailing in the year preceding the award period. As per the accounting practice adopted by both the Planning and Finance Commissions, all additional revenues mobilised during a plan period by raising rates or by widening the tax and non-tax bases are meant for financing plan expenditure. In the absence of separate data for additional revenue mobilisation, the figures of revenue used by us in Table II-5 and Table II-6 are inclusive of additional revenue mobilised during the plan periods.<sup>6</sup> This implies that even after utilising all the additional revenue mobilised, the State could not meet its non-plan revenue expenditure fully and the non-plan gaps could still not be filled. This further implies diversion of plan funds for current consumption from new investment.

With mounting deficits in the State's non-plan revenue account even after deploying all additional revenues mobilised and even after availing itself of all non-plan grants- statutory and discretionary - the State's plan revenue expenditure had to be financed entirely by Central Plan grants from the Seventh Plan onwards. Besides, the State's revenue plan expenditure (including expenditure on Central and Centrally Sponsored Plan Schemes) was higher than the total Central plan grants (including grants for Central and Centrally Sponsored Schemes).<sup>7</sup> This left deficits on revenue plan account also (see Table.II-6). During earlier years, prior to 1985-86, the State had meagre non-plan surpluses after mobilising additional resources and after availing itself of all non-plan, non statutory grants. But during two years of the Fifth Plan (1975-76 and 1976-77) and three years of the Sixth Plan (1980-81, 1983-84 and 1984-85), these surpluses were



inadequate to cover the gap between State's plan revenue expenditure and Central Plan Grants. This led to deficits in overall revenue account during these years. During all the years of the Seventh Plan, and ever since (except 1995-96) the deficits on plan account were in fact, compounded with the deficits on non-plan account. This has important implications for the size of the State's plan outlays as will be seen in Chapter VI.

In the above situation, the only alternative for Kerala was to get its revenue deficits financed by generating capital surpluses. This is precisely what the State seems to have done during all years of the Seventh Plan except 1986-87. In 1985-86, State's capital surpluses were adequate to finance revenue deficits. But from 1987-88 onwards, they turned out to be inadequate, leaving overall deficits. The same was the position in four years of the nineties.

It will be argued later in Chapter V that the magnitude as well as the peculiarity of Kerala's fiscal crisis discussed above is built into the very pattern of State's public expenditure, weighed as it is in favour of Social and community Services. By their very nature, the expenditure on these services are largely on revenue account unlike in the case of Economic Services. Thus, a higher share of expenditure on Social and Community Services in the total expenditure leads to a larger revenue component. Most of these expenditure is for wages, salaries and pensions which are of a recurring nature. These, per force, will have to be continued even after the end of a Five Year Plan period. This partly accounts for the larger non-plan expenditure of Kerala. The inadequate appreciation of the budgetary implications of Kerala's pattern of expenditure by the funding agencies like the Planning Commission and the Finance Commissions has contributed to the gravity of the problem.. This aspect will be discussed in greater detail in Chapter IV.

**Notes and References**

1. For a detailed discussion of the budgetary crisis of both the states and the Union, see Government of India, First and Second Reports of the Ninth Finance Commission, and the Report of the Tenth Finance Commission, 1988, 1989 and 1994.
2. In India, government expenditure is divided into Plan and Non-Plan. Plan expenditure is the expenditure on new projects included in a Five Year Plan as well as those on incomplete projects carried forward from the previous Plans. Most of these projects are of developmental nature. Recurring expenditure on all schemes completed during a Five Year Plan are treated as non-plan at the end of the plan. There is an element of arbitrariness in the classifications. All debt service payments and pensions to government staff are included under non-plan. Non-plan expenditure are not synonymous with non developmental as a good portion of the non-plan expenditure are developmental in nature.
3. Finance Commission is the agency envisaged under the Indian constitution to decide fiscal transfers between the federal government (known usually as the Centre or Central government or Union government) and the various State governments. Its importance has been coming down with the advent of centralised economic planning. It is now the Planning Commission and the different Union ministries which account for the bulk of Central transfers. The Finance Commission is appointed every five year or earlier. So far, ten Finance Commissions have submitted their reports.

Statutory transfers refer to the financial transfers effected on the recommendations of the Finance Commissions. These transfers are effected in two ways (1) sharing of the proceeds of two important federal taxes viz. Personal income tax and Union Excise Duties usually referred to as devolution. (2) grants in aid to those states in need of assistance under Article 275 of the constitution. These grants are known as the statutory grants.

4. Non-Plan, non-statutory grants are decided by the Union ministries. They are given to states which execute Central Government schemes outside the Five Year Plan. These grants also include grants for meeting natural calamities.



5. See (a). Gulati I.S. and George.K.K. "Eighth Finance Commission's Award" in *Essays in Federal Financial Relations*, Oxford IBH, Delhi, 1988.  
(b). George K.K., "Ninth Finance Commission's Report: An Appraisal" *Economic and Political Weekly*, April 1, 1989.
6. Accounts data on additional resource mobilisation (ARM) are not readily available.
7. Plan grants are meant for financing (1) the State's own Five Year Plan (2) Central and Centrally Sponsored Plan schemes executed through the state budgets. Bulk of the funds for these schemes come from the Central government. Many of the schemes have matching provisions.

Table II-1 Gross Fiscal Deficit - Movement Over the Years

	Kerala				All States				(Rs.Crores)
	Expend- ture	Surplus(+)/ Deficit (-)	(2) as % of (1)	(2) as % of GDP	Expend- ture	Surplus(+)/ Deficit (-)	(6) as % of (5)	(6) as % of GDP	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
1990-91	3201.4	-798.5	-24.9	-6.6	85253.7	-18786.9	-22.0	-4.8	
1991-92	3655.5	-803.4	-22.0	-5.3	99935.8	-18900.1	-18.9	-4.6	
1992-93	4050.7	-732.0	-18.1	-4.3	111982.4	-20891.3	-18.7	-4.1	
1993-94	4857.3	-935.2	-19.3	-4.8	126159.7	-20596.7	-16.3	-3.4	
1994-95	5575.1	-1108.7	-19.9	-5.0	149980.6	-27696.6	-18.5	-4.0	
1995-96	6726.3	-1302.7	-19.4	-5.2	168229.2	-31425.8	-18.7	NA	
1996-97 RE	8490.4	-2025.2	-23.9	-7.1	199059.8	-41844.6	-21.0	NA	
1997-98 BE	9746.4	-1977.3	-20.3	NA	221907.8	-45529.6	-20.5	NA	

Source: Finances of State Governments, R.B.I. Bulletin, compiled from various issues.

Note. 1. GFD is the difference between aggregate disbursements net of debt

repayments and recovery of loans, revenue receipts and non-debt capital receipts.

2. RE- Revised Estimates - These are likely to be revised further but are more reliable than the Budget Estimates

BE- Budget Estimates - These are liable for large variations from actuals.

All other figures are actuals from audited accounts.

**TABLE II-2**  
**Comparative Position of Budgetary Surplus/Deficit**  
**of Kerala and All States**

(Amount in crores of rupees)

Year	Revenue Account		Capital Account		Overall	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	0.3	394.7	11.9	-383.0	12.9	11.6
1975-76	-3.4	971.7	-12.8	-295.2	-16.3	676.5
1976-77	-3.3	1096.8	-11.6	-943.3	-14.9	153.5
1977-78	29.1	1019.1	-3.2	1089.0	25.9	-69.8
1978-79	43.0	1135.4	2.6	-3.9	68.9	1131.5
1979-80	57.9	1548.3	37.1	-1509.1	20.9	39.2
1980-81	-27.2	1485.4	-42.1	-1703.9	-63.9	-218.4
1981-82	96.0	1379.4	-157.9	-1663.5	-61.9	-284.2
1982-83	26.8	888.1	4.2	-1035.5	31.0	-145.3
1983-84	-58.2	210.5	42.3	-376.9	-16.0	-166.4
1984-85	-13.7	-923.5	-63.5	-350.2	-77.2	-1273.8
1985-86	-74.2	658.7	194.8	1047.9	120.6	1706.5
1986-87	-152.2	39.4	-18.8	-354.1	-171.1	-314.6
1987-88	-194.6	-1088.1	188.2	801.8	-1.6	-65.6
1988-89	-163.9	-1806.9	117.1	2202.3	-1.1	379.7
1989-90	-250.5	-3681.9	226.1	3549.1	7.3	-160.9
1990-91	-422.1	-5308.9	405.6	5534.5	-24.6	71.5
1991-92	-364.3	-5650.8	316.3	6210.9	-72.5	-155.8
1992-93	-337.4	-5114.1	427.5	6943.5	90.1	1829.3
1993-94	-371.3	-3812.5	470.8	3350.7	99.5	-461.7
1994-95	-399.9	-6156.2	799.5	10623.9	399.6	4467.7
1995-96	-402.8	-8200.6	467.8	11050.3	65.0	2849.7
1996-97 RE-1007.1		-15855.2	583.9	11532.9	-423.2	-4322.3
1997-98 BE-1242.1		-16385.5	1027.8	13943.1	-214.3	-2442.4

Notes and References:

- I. Figures of surplus and deficit are those given in the "Finances of State Governments," R.B.I. Bulletin, various issues. They differ from those given in the state budgets.

**TABLE II-3**  
**Ratio of Revenue Surplus/Deficit to Revenue Expenditure**  
**(1974-98)**

(In percentage)		
YEAR	KERALA	ALL STATES
1974-75	0.1	6.5
1975-76	-1.0	13.9
1976-77	-0.8	13.8
1977-78	7.0	11.4
1978-79	9.0	10.8
1979-80	10.9	12.8
1980-81	-4.1	10.8
1981-82	12.7	8.1
1982-83	3.4	4.4
1983-84	-5.9	0.9
1984-85	-1.2	-3.3
1985-86	-5.1	2.0
1986-87	-9.2	0.1
1987-88	-10.9	-2.4
1988-89	-7.9	-4.1
1989-90	-10.8	-6.1
1990-91	-14.9	-7.4
1991-92	-11.3	-6.6
1992-93	-9.2	-5.3
1993-94	-8.6	-3.5
1994-95	-7.9	-4.8
1995-96	-6.9	-5.6
1996-97 RE	-13.4	-9.2
1997-98 BE	-14.2	-8.5

TABLE II-4

**Ratio of Revenue Surplus/Deficit to Total Capital Receipts  
and Receipts in Public Accounts**

(In percentages)

YEAR	Total Capital Receipts		Receipts in Public Accounts	
	Kerala	All States	Kerala	All States
1974-75	0.3	18.2	1.2	148.8
1975-76	-3.6	32.5	-15.3	261.2
1976-77	-2.7	38.0	-13.0	223.2
1977-78	22.1	31.9	93.4	176.9
1978-79	25.2	22.1	106.8	133.5
1979-80	41.7	36.2	231.0	225.5
1980-81	-18.7	26.6	-102.6	140.6
1981-82	55.4	22.6	313.8	130.5
1982-83	12.3	12.4	45.6	60.6
1983-84	-16.0	2.3	-60.4	11.7
1984-85	-3.7	-8.5	-19.3	-48.7
1985-86	-10.3	5.0	-65.2	30.3
1986-87	-25.9	0.3	-127.8	1.6
1987-88	-29.6	-7.0	-89.8	-16.6
1988-89	-28.4	-10.6	-158.6	-25.4
1989-90	-30.6	-18.3	-118.3	-41.6
1990-91	-44.0	-21.4	-125.1	-48.8
1991-92	-32.9	-20.2	-131.6	-38.0
1992-93	-29.7	-17.0	-117.2	-30.1
1993-94	-28.2	-13.3	-89.4	-26.8
1994-95	-23.6	-14.1	-74.1	-58.5
1995-96	-25.8	-18.8	-89.5	64.6
1996-97 RE	-55.2	-33.2	-198.2	-157.1
1997-98 BE	-54.9	-30.6	-218.7	-135.5

## Notes &amp; References:

- Public Accounts include Small Savings, Trust and Endowment Funds, Insurance and Pension funds, Reserve Funds, Deposits and Advances, Suspense and Miscellaneous, Remittances and Cash Balances.
- Total Capital Receipts include Receipts in Public Accounts, Loans from the Central government, Market borrowings and Negotiated Loans.



**TABLE II-5**  
**Non-Plan Revenue Surplus/Deficit before and after**  
**Devolution and All Statutory Transfers**

(Amount in crores of rupees)

Year	Before Devolution		After Devolution		After all Statutory Transfers	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	-87.3	-1195.7	-40.1	32.8	3.8	520.0
1975-76	-100.1	-966.3	-38.4	632.8	5.1	1143.2
1976-77	-86.7	-816.7	-21.8	863.1	19.4	1383.4
1977-78	-63.9	-1239.1	5.2	566.7	49.7	1130.3
1978-79	-53.8	-1313.5	21.4	639.3	70.5	1164.4
1979-80	-44.6	-1901.5	92.0	1505.9	92.3	1761.9
1980-81	-106.5	-2141.3	45.0	1647.6	45.0	1897.6
1981-82	-22.0	-2420.3	148.8	1839.4	149.0	2090.2
1982-83	-109.1	-3218.1	76.8	1414.6	76.9	1656.3
1983-84	-192.9	-3776.2	16.6	856.5	18.6	1124.4
1984-85	-170.7	-5253.3	62.6	601.1	63.6	1045.3
1985-86	-372.7	-6301.8	-164.2	955.4	-153.8	1567.3
1986-87	-456.7	-6456.9	-117.5	1860.5	-111.9	2743.3
1987-88	-407.8	-7958.5	-118.5	1535.1	-104.4	2670.6
1989-89	-493.4	-10426.3	-56.6	309.7	-53.5	1346.2
1989-90	-572.9	-13543.1	-117.0	-445.8	-107.8	983.5
1990-91	-883.5	-17813.1	-397.3	-3571.6	-333.3	-1343.7
1991-92	-897.8	-21790.7	-321.3	-4942.8	-316.6	-2822.6
1992-93	-959.2	-25348.4	-272.2	-4768.2	-266.7	-2651.0
1993-94	-995.4	-27661.2	-244.3	-5266.4	-238.0	-3402.7
1994-95	-1109.5	-28934.6	-271.1	-4049.9	-264.7	-2210.9
1995-96	-988.0	-33078.1	48.9	-4030.5	62.4	-59.0
1996-97 RE	-1596.2	-43026.1	-378.5	-8400.0	-363.2	-4243.4
1997-98 BE	-1467.1	-48323.3	-66.7	-8208.6	-51.4	-5836.4

Notes:

1. Devolution refers to the share of Central taxes accruing to the States.
2. Statutory Transfers - Devolution Plus Statutory grants under Article 275 of the Constitution.

Table II-6

## Revenue Deficit of Kerala in Plan and Non-Plan Accounts

(Amount in lakhs of rupees)

Year	Non-Plan deficit(-) Surplus(+) after All Statutory Transfers	Non-Plan Deficit(-)/ Surplus(+) after all Non-Plan Grants	Deficit(-) Surplus(+) on Plan Rev. Ac.	Overall Revenue Deficit
1974-75	379	643	-615	28
1975-76	509	613	-962	-349
1976-77	1942	2037	-2367	-330
1977-78	4974	5128	-2223	2905
1978-79	7051	7151	-2848	4303
1979-80	9229	9448	-3655	5793
1980-81	4503	5106	-7828	-2722
1981-82	14954	15921	-6323	9598
1982-83	7686	7999	-5321	2678
1983-84	1863	2149	-7969	-5820
1984-85	6356	8335	-9702	-1367
1985-86	-15381	-4687	-2729	-7416
1986-87	-11187	-9220	-6004	-15224
1987-88	-10438	-9866	-9593	-19459
1988-89	-5346	-3054	-13340	-16394
1989-90	-10783	-8355	-16690	-25045
1990-91	-33329	-27436	-14766	-42202
1991-92	-31662	-26471	-9962	-36433
1992-93	-26668	-21985	-11756	-33741
1993-94	-23797	-20272	-16859	-37131
1994-95	-26467	-23077	-16911	-39988
1995-96	6237	12782	-53069	-40287
1996-97RE	-36315	-33700	-67006	-100706
1997-98BE	-5142	-219	-124012	-124321

Notes:

- 1 Non-Plan Grants include statutory grants under Article 275 of the Constitution, grants for natural calamities given on the recommendations of the Finance Commission and other non-statutory, non-plan grants given by the different ministries of the Central government for financing their different schemes outside the Five Year Plans.
- 2 Deficit on Plan account = Central Plan Grants (for State Plans, Central and Centrally Sponsored Schemes) minus Plan Revenue Expenditure (under State Plan, Central and Centrally Sponsored Schemes).

## CHAPTER III

### LIMITS TO RESOURCE MOBILISATION

In this chapter, it is proposed to examine whether it is the slackness in the resource mobilisation efforts of the State government that has led to its present fiscal crisis which in turn has impaired its capacity to finance public expenditure as in the past <sup>1</sup>. Our analysis shows that the State's resource mobilisation efforts compare very favourably with those of other states. Despite its best efforts, the resources mobilised by the State fall far short of its requirements because of the slow growth of its resource base. This, in turn, is due to the slow growth of its economy. The pattern of growth - slower growth in the commodity producing sectors and the relatively higher growth in the tertiary sectors - has accentuated the problem as the states in India are precluded from taxation of services under the constitutional division of powers. They are also precluded from taxing personal or corporate income which prevents the State from taxing the income flowing from the emigrants to the Gulf region. No doubt, the State's strategy of relying mostly on commodity taxation and not on non-tax revenues has also been a contributory factor for the inadequacy of resources mobilised.

Table III-1 gives the share of own funds in financing the State's expenditure. This Table brings out clearly that Kerala's reliance on its own funds has been much more than that of All States from the year 1977-78 onwards. Only the year 1986-87 was an exception.

Table III-2 gives the ratio of state's own revenue to state domestic product for Kerala and All States. This Table shows that Kerala's resource mobilisation efforts had been much better than that of All States. Ratios of Kerala's own revenues to state domestic product

are consistently higher than that of All States during all the years. These above average resource raising efforts have to be seen in the context of the State's per capita income which has always been lower than the all-states average.

Table III-3 shows the per capita revenue, both tax and non-tax, of Kerala and All States. Despite its low resource base, Kerala's resource mobilisation in per capita terms has been always higher than that of All States.

### **State's Tax Efforts**

If Kerala's tax-sdp ratio is taken separately, we find that it was steadily increasing till 1981-82. There was a fall in this ratio in 1982-83, 1983-84 and 1984-85. But even in these years, the State's ratios were higher than those of All States. During subsequent years, the State's tax-sdp ratio picked up considerably and reached a record high of 13.6 per cent in 1995-96. This tax-sdp ratio in a way is an underestimate as some of the taxes like Profession Tax, Entertainment Tax and Building Tax are levied and collected by local bodies directly in Kerala unlike in many other states.

Our findings regarding the State's tax efforts are corroborated by all studies on states' tax efforts still now.<sup>2</sup> The study conducted by the National Institute of Public Finance and Policy (N.I.P.F.P) for the Eight Finance Commission had placed Kerala among the states with "above average tax efforts".<sup>3</sup> The first report of the Ninth Finance Commission, using Aggregate Regression Approach found that the trend estimates of Kerala's tax revenues for 1989-90 were higher than its normative estimates.<sup>4</sup> Using a different method, viz., a modified version of the Representative Tax System, the Ninth Finance Commission in its second report found that Kerala's tax effort was better than the norm worked out by it.<sup>5</sup> The Tenth Finance Commission found that the buoyancy coefficients of most of the major state taxes were one of the highest in Kerala.<sup>6</sup>

The scope for further raising of tax-rates appears to be limited in Kerala. The rates of sales tax and state excise duties in the State are

higher than in the bordering states of Tamil Nadu and Karnataka. These rates in Kerala are very much higher than in Mahe, a Union Territory which is almost a tax haven (This territory forming part of Pondichery is contiguous to Kerala). Further hiking of tax rates can only aggravate the trend towards trade diversion that exists even at present. This is particularly true in the case of high value, low bulk commodities. The small size of the state makes trade diversion easier. Already, 'Kerala Markets' have sprung up in Mahe and the border towns of Tamil Nadu and Karnataka to attract the consumers from the State. Besides, any further raising of rates can reinforce the tendency, which already exists, for shifting economic activities across the State's borders, for a number of other reasons.

The State's capacity for additional resource mobilisation is severely constrained by the low level and slow growth of per capita sdp, as noted earlier. The Kerala pattern of economic growth together with the division of taxing powers between the Centre and States has further hindered the tax efforts of the State. Agricultural production in the State has been growing only very slowly. Index of Agricultural Production (base year: average of triennium ended 1978-79) had increased only to 150 by 1996-97. Apart from this slow growth in agriculture, the cropping pattern in the state too is posing problems in taxing agricultural commodities. The State concentrates on cash crops which are sold either outside the State or outside the country. During recent years, the only major crops of the State which have shown increases in production are plantation crops, oil seeds and spices. The bulk of these crops are sold outside the State. Similarly, the major portion of the marine products (fisheries sector was one of the few sectors which showed high growth rate) is exported. The State's power to impose higher tax rates on these commodities is subject to central legislation covering inter-state trade and export sales. Amendment to Section 5 of Central Sales Tax Act in 1975-76, prevents imposition of Sales Tax on export commodities not only at the ultimate point of export sales but also at the penultimate point. This has adversely affected the ability of the State to raise taxes from the few buoyant sub-sectors of the economy. Export commodities like spices, tea, coffee, cashew and marine products used to fetch



Rs.23 crores for the State's exchequer before the amendment. For 1986-87, the loss is estimated at Rs.110 crores.<sup>7</sup> No doubt, these restraints were imposed as an export promotion measure in national interest. But the State's claim for compensation for loss is equally justified. The State's demand for compensation from the Centre had been conceded in parliament. But this promise still remains to be honoured. .

The presence of legal loop-holes (relating to consignment sales, branch transfers and direct sales by producers) and the oft complained non co-operation in tax co-ordination by railway authorities have facilitated sales tax evasion. A large proportion of the output of certain crops like rubber and copra is sold in the form of consignment transfers on which sales tax cannot be imposed by the State.

As for direct taxation of agriculture, the peculiar land holding pattern in the State poses problems. The average size of the holdings in 1990-91 was only 0.33 hectares. Large holdings (10 hectares and above) account for only 9.7 per cent of the area and 0.06 per cent of the number of holdings in the State. Even plantation crops like rubber are cultivated largely in small plots in the State.

The share of manufacturing in sdp is lower in Kerala (13.3 per cent) than in the country as a whole (21.9 per cent). Even within the manufacturing sector, unregistered sector contributed about 47 per cent to the industrial income as against 38 per cent for the country as a whole. Most of the unregistered units in Kerala are in the declining traditional sector (eg. coir, handloom, beedi etc.). They, in fact, require fiscal support for their very survival and cannot be expected to contribute to the State's taxes. Thus, the low share of manufacturing sector in sdp and the dominance of non-factory sector within this sector place severe constraints on the State's capacity to tax even the industrial income. Besides, a high proportion of the output of the registered manufacturing sector is sold outside the State. This, as noted earlier, restricts the State's capacity to impose higher rates of sales tax as the maximum rates are prescribed in the Central legislation. Besides, a good portion of this trade also is taking place by means of consignment sales or branch transfers which are used today as devices to avoid sales tax.

It is not that the State can do absolutely nothing more on the taxation front. As may be seen from Table III-4, the State seems to be relying increasingly on commodity taxation. The share of these taxes in total tax revenue of the State (excluding share in Central taxes) ranged between 85 to 90 per cent between 1974-75 and 1997-98. Correspondingly, the share of taxes on income, has been coming down. This trend should and could be reversed. There appears to be further scope for resource mobilisation through taxes on property and capital transactions in view of the high average value of assets per household in Kerala (Rs. 54,674 against Rs.20,204 for the country). The value of buildings too was higher in Kerala (Rs.17,411 and Rs.9,141).<sup>8</sup> The average value of land per household, despite the low size of holdings noted earlier, indicates the higher value of land in the State. In spite of this, the share of taxes on properties and capital transactions has not been much higher than the All States average due to large scale evasion by under reporting of values. One positive trend that is visible from the Table is the reversal of the downward trend in the share of these taxes from 1988-89. In view of the limited scope for additional commodity taxation discussed earlier, it appears that a new strategy of taxation relying more on direct taxes is called for, notwithstanding the narrow tax base for states left by the Indian constitution.

The scope for increasing tax collection by increasing tax rates or widening the tax base is limited in the state for reasons mentioned earlier. But there is still considerable scope for collecting more taxes by toning up tax administration. The State's tax administration machinery does not appear to be well equipped for coping with the task of controlling tax evasion. In addition to the usual causes like inefficiency, corruption and political interference, the absence of a computerised information system on production, consumption, inter-state trade, exports and imports seems to have facilitated evasion considerably.

### **State's Efforts in Mobilising Non-Tax Revenues**

It was seen from Table III-2 that there was some deceleration in the growth of revenue in relation to sdp during some years of the Sixth Plan. This was largely on account of deceleration in the growth of non- tax revenues.

The ratio of non-tax revenue to sdp (except for an abnormal rise to 6.2 per cent in 1981-82) was generally coming down over the years. What is more, the State's ratio was lower than that of All States from 1981-82 onwards.. In per capita terms too, Kerala's non-tax revenue collections were lower than that of All States from the Sixth Plan onwards.

There are other indications of the State's poor efforts in tapping non-tax revenues. The share of non-tax revenue in total own revenue was lower than that of All States during all the years except 1981-82 (see Table.III-5). The share of non-tax revenues which was closer to All States average in the seventies started declining steadily in the eighties and the nineties. It stood at 10.4 per cent during 1997-98 against the All States average of 22.2 percent.. As may be seen from Table III-3, State's own non-tax revenue in per capita terms was marginally higher than for All States during the Fifth Plan. During the Sixth Plan, it became slightly lower than that of All States. During the subsequent Plan periods, Kerala's per capita non-tax revenues were considerably lower than that of All States.

The State's capacity to raise tax revenues by increasing tax rates is rather limited by the constraints noted earlier. But there appears to be further scope to raise its non-tax revenue. No doubt, the low level and growth of per capita income place constraints here also. The high rates of taxes too pose a constraint as the bases of these two sources of revenues often overlap.

The ratio of interest receipts to outstanding loans extended by the State government shows considerable annual fluctuations as may be seen from Table III-6. These fluctuations are caused largely by the failure of the State Electricity Board and the Kerala State Road Transport Corporation, (two of the biggest borrowers from the State government).

There is definitely scope for Kerala raising more non-tax revenues from its public sector enterprises and co-operative institutions. Kerala's share in the total equity investments in these state level enterprises by all states had been high (6.1 per cent). Yet, all these enterprises and institutions contributed only Rs. 4.3 per cent

of the dividends. Dividends represented only 0.3 percent of the total equity investments as against the All-States average of 4.4 per cent.<sup>9</sup> Of the 110 State owned enterprises, only 41 units were making any profits in 1996-97. As against their profits aggregating Rs.131 crores, losses of the other units totalled Rs.254 crores, resulting in a net loss of Rs.123 crores. Fifty five units had carried forward losses aggregating Rs.1624 crores. Thirty three enterprises had negative worth.<sup>10</sup>

Certain components of non-tax revenues have a built-in tendency to decline in relative terms which is important to note in the context of Kerala Model of Development. As may be seen in Table III-7, annual revenue receipts from Social and Community Services and Economic Services in relation to the government's revenue expenditure on these services had been showing a declining trend. This ratio in case of Social and Community Services, which was 5.6 per cent in 1974-75, slipped to 2.1 per cent during 1997-98. No doubt, Kerala's performance in this regard has been slightly better than that of All States. Steep downward trend is also noticed in the ratio of receipts from Economic Services to expenditure on them. From 49.1 per cent in 1974-75, the ratio fell to 10.4 per cent in 1997-98. The Table shows that the cost recovery rates of economic services are considerably lower for Kerala than for All States. But, as may be expected, they were higher than those of Social and Community Services by a wide margin.

The low recovery rates of Social and Community Services as compared to Economic Services depresses the non-tax revenues of Kerala more than those of other states in view of the substantially larger share of these services in Kerala's expenditure. To add to this problem, Kerala's recovery rates on economic services too were much lower.

The above discussion brings out clearly the State's failure to rationalise its expenditure or to collect at least a portion of its expenditure from the users of services by appropriate pricing. The failure to tap this potential has resulted in the general tax payers being compelled to subsidise heavily the particular users of government services. It is true that pricing of social and economic services that



are provided by state government may have to have some built-in subsidies in them, particularly to the extent that these services are targeted at weaker groups which need to be supported on social grounds. But can the State's exchequer with its burgeoning fiscal deficits afford the present quantum of subsidies? Besides, these hidden subsidies are on the increase as most of the prices for services had not been revised for years. What is more, exemptions from payment for different services have been increasingly made. Not all these hidden subsidies are targeted specifically at weaker sections. It is doubtful whether a state like Kerala with its perennial fiscal crisis and growing need for public expenditure can afford indiscriminate provision of subsidies, hidden or open.

### **Need for a New Strategy for Resource Mobilisation**

As pointed out earlier, the major reason for the State's fiscal crisis from the resources side is the slow growth of its resource base rather than the slackness in its resource efforts. But Kerala's strategy of resource mobilisation also must bear part of the blame. This strategy does not appear to be very appropriate, given the model of development the State pursued. The State was relying heavily on taxation, particularly commodity taxation. The share of taxes on income had been coming down. Where contiguous states impose lower tax rates, there is a limit for an individual state, especially a small state like Kerala to mop up revenue by increasing the tax rates. The excessive reliance on commodity taxation has become counter-productive. Besides, this strategy does not appear to be very appropriate or sustainable in an economy where the growth in service sectors is considerably more than in commodity producing sectors. The present strategy is also inappropriate in view of the government's expenditure pattern favouring Social and Community Services. Since this pattern does not lead directly to increase in commodity production, indirect recovery of cost through commodity taxes is difficult. The government has to recover more of the expenditure on these services by increasing the user charges. Similarly, the government which had in the past assumed a direct role in economic activities has to ensure that its past investments do generate adequate returns to sustain its public expenditure.

## Notes and References

1. For the view that there was a slackening of resource mobilisation efforts, See Bagchi Amaresh and Rao Govinda, *Review of Plan Financing in Kerala during the Sixth Plan*, National Institute of Public Finance and Policy (N.I.P.F.P), New Delhi, 1987.
2. (a) Reddy K.N. "Inter-State Tax Effort," *Economic and Political Weekly*, Dec.13,1975.  
 (b) Rao Hanumantha, C.M, *Growth, Poverty and Tax Effort*, Institute of Economic Growth, Delhi,1979 (mimeo)  
 (c) Oomen M.A., "Relative Tax Effort of States", *Economic and Political Weekly*, Vol.XXII, No.11.
3. Government of India, *Report of the Eighth Finance Commission*, 1984 p.139
4. *First Report of the Ninth Finance Commission*, 1988.
5. *Second Report of the Ninth Finance Commission*, 1989.
6. *Report of the Tenth Finance Commission*, 1994.
7. See (1). Mani.K.M. *Fiscal Problem of Kerala* (Malayalam) Trivandrum, 1984. Mr. K.M.Mani was the Minister of Finance of Kerala under successive coalition governments.  
 (2). Government of Kerala, Memorandum to the Ninth Finance Commission, Trivandrum 1988, p.27.
8. Reserve Bank of India, *All India Debt and Investment Survey, 1981-82, Assets and Liabilities of Households as on 30<sup>th</sup> June, 1981*, Bombay 1987.
9. *Report of the Tenth Finance Commission*, 1994.
10. For details, see Government of Kerala, *A Review of Public Enterprises in Kerala, 1996-97*, Trivandrum 1998.

**TABLE III-1**  
**Share of Own Funds in Financing State's Expenditure (1974-98)**

(In percentages)

Year	Revenue Expenditure		Capital Expenditure		Total Expenditure	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	61.2	69.3	58.4	42.9	61.2	61.4
1975-76	62.7	73.5	43.9	51.7	58.3	66.5
1976-77	65.3	73.7	40.1	37.6	58.8	61.9
1977-78	70.7	70.5	46.1	30.0	64.7	57.4
1978-79	72.3	68.7	41.9	37.2	65.2	58.3
1979-80	77.4	67.4	37.3	27.7	67.4	54.5
1980-81	65.4	66.7	37.8	35.1	59.3	56.3
1981-82	80.4	67.2	24.1	35.1	63.2	57.1
1982-83	70.8	64.8	51.0	36.5	66.6	56.6
1983-84	61.0	62.7	51.2	44.3	58.6	57.4
1984-85	66.3	59.3	36.2	44.3	58.0	55.0
1985-86	60.3	60.8	55.9	39.5	59.2	55.0
1986-87	59.1	60.2	40.1	41.2	54.6	55.2
1987-88	62.6	57.8	75.8	44.8	65.3	55.0
1988-89	60.5	57.5	62.6	47.9	60.8	55.4
1989-90	61.2	58.0	79.1	53.5	64.9	57.0
1990-91	54.8	55.2	99.5	56.3	62.1	55.4
1991-92	59.3	56.2	67.2	68.5	60.9	58.7
1992-93	59.3	54.8	85.6	73.4	63.5	58.4
1993-94	62.1	56.7	85.2	56.2	65.9	56.6
1994-95	63.1	60.3	105.6	74.0	69.4	63.1
1995-96	67.3	59.8	82.9	73.8	69.7	62.4
1996-97RE	60.2	55.6	87.2	61.6	64.1	56.6
1997-98BE	60.0	56.1	106.2	65.2	65.7	57.7

Note: Own Capital funds here include, net accretion to Public Accounts, Market borrowings and negotiated loans from financial institutions, but exclude loans from the Centre.

**TABLE III-2**  
**Ratio of Own Revenue to State Domestic Product**

(In Percentages)

Year	Tax Revenue		Non-Tax Revenue		Total Revenue	
	Kerala	All States*	Kerala	All States*	Kerala	All States*
1974-75	5.9	5.4	2.7	2.3	8.6	7.7
1975-76	7.2	6.5	2.8	2.7	10.0	9.2
1976-77	7.8	6.7	2.8	2.9	10.6	9.6
1977-78	8.5	6.3	3.2	2.8	11.7	9.1
1978-79	9.2	6.8	3.4	3.0	12.6	9.8
1979-80	9.2	7.1	3.9	3.0	13.1	10.1
1980-81	9.4	7.0	2.8	2.9	12.2	9.9
1981-82	10.1	7.7	6.2	2.9	16.3	10.6
1982-83	9.3	7.7	2.5	2.9	11.8	10.6
1983-84	8.8	7.3	2.2	2.8	11.0	10.1
1984-85	9.7	7.6	2.1	2.8	11.8	10.4
1985-86	11.2	8.2	2.2	3.0	13.4	11.2
1986-87	11.1	8.6	2.2	3.2	12.3	11.8
1987-88	11.2	8.6	2.3	3.0	13.5	11.7
1988-89	11.6	8.3	2.0	2.8	13.6	11.2
1989-90	11.6	8.4	1.6	2.9	13.2	11.3
1990-91	11.0	8.4	1.7	2.6	12.7	11.0
1991-92	11.1	8.6	1.6	3.0	12.6	11.6
1992-93	11.0	8.4	1.6	2.7	12.6	11.2
1993-94	11.9	8.4	1.6	2.8	13.6	11.2
1994-95RE	12.7	8.7	1.8	3.4	14.5	12.1
1995-96BE	13.6	9.0	2.2	3.2	15.8	12.3

\*Relates to 14 major states only



TABLE III-3

## Per capita Own Revenue of States (1974-97)

(In rupees)

	Own Tax Revenue		Own Non-Tax Revenue		Total Own Revenue	
	Kerala	All States	Kerala	All States	Kerala	All States
V PLAN	87.8	73.1	33.6	32.8	121.4	105.9
VI PLAN	177.4	140.2	55.0	55.8	232.4	196.0
VII PLAN	373.9	287.3	68.4	98.5	442.2	385.9
Annual Plans	507.5	395.4	74.7	131.3	582.1	526.7
VIII PLAN	967.2	658.5	140.5	229.3	1107.7	887.8
Total	2113.7	1554.5	372.2	547.7	2485.8	2102.3

Note: Per capita figures in this and subsequent Tables have been calculated with 1971 population figures for V Plan and 1981 population figures for VI, VII and Annual Plans and 1991 population figures for VIII Plan.

**TABLE III-4****Share of Different Categories of Taxes in State's Own Tax Revenue**

(In Percentages)

Year	Taxes on Income		Taxes on Property and Capital Transactions		Taxes on Expenditure and Services	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	3.3	0.6	12.0	12.9	84.6	86.5
1975-76	4.6	1.3	10.6	12.9	84.4	85.8
1976-77	3.5	1.4	10.1	10.5	86.4	89.1
1977-78	4.7	2.2	9.6	10.5	85.6	87.3
1978-79	4.4	2.4	10.3	10.6	85.3	87.0
1979-80	3.8	1.9	9.2	9.3	87.1	88.8
1980-81	3.4	1.6	8.7	8.7	87.9	89.6
1981-82	2.4	1.4	8.8	8.8	88.9	89.4
1982-83	2.5	1.3	8.3	8.3	89.2	90.4
1983-84	2.7	1.4	8.9	8.2	88.4	90.4
1984-85	2.4	1.4	8.4	8.2	89.2	90.4
1985-86	2.9	1.9	7.3	8.3	89.9	89.8
1986-87	2.0	1.6	7.7	8.4	90.2	90.0
1987-88	1.0	1.4	8.3	8.9	90.7	89.7
1988-89	1.3	1.4	10.4	9.4	88.3	89.2
1989-90	1.3	1.7	10.4	9.8	88.3	88.4
1990-91	1.8	2.1	10.2	9.0	88.0	88.9
1991-92	2.1	1.8	10.0	9.3	87.9	88.9
1992-93	0.7	1.5	11.1	9.1	88.3	89.4
1993-94	0.9	1.4	11.0	9.5	88.1	89.3
1994-95	0.6	1.3	11.6	11.3	87.8	87.4
1995-96	0.8	1.3	11.4	11.4	87.8	87.3
1996-97 RE	0.7	1.4	12.6	10.9	86.6	87.7
1997-98 BE	0.6	1.3	11.5	11.0	87.8	87.7

- Notes: 1. Taxes on income are Agricultural Income Tax and Profession Tax  
 2. Taxes on Property and Capital transactions include  
     (1) Stamps and Registration  
     (2) Land Revenue;  
     (3) Taxes on Urban Immovable Property; and  
     (4) Surcharge on Cash Crops.

**TABLE III-5**  
**Share of Own Non-Tax Revenue in Total Own Revenue**  
**(1974-98)**

Year	(In Percentages)	
	Kerala	All States
1974-75	30.9	31.1
1975-76	28.2	30.7
1976-77	26.7	31.1
1977-78	27.4	30.8
1978-79	26.6	31.2
1979-80	29.6	30.3
1980-81	22.9	33.0
1981-82	38.3	28.2
1982-83	21.0	27.6
1983-84	19.5	27.9
1984-85	17.7	27.1
1985-86	16.2	26.7
1986-87	16.8	26.7
1987-88	16.9	25.9
1988-89	14.5	25.4
1989-90	12.4	25.6
1990-91	13.5	23.3
1991-92	12.3	26.2
1992-93	12.9	24.4
1993-94	12.1	25.1
1994-95	12.4	28.0
1995-96	13.7	26.4
1996-97 RE	12.3	24.8
1997-98 BE	10.4	22.2

Source : "Finances of State Governments" R.B.I. Bulletin, various issues

TABLE III-6

**Ratio of Interest Receipts to Outstanding Loans of Kerala  
(1974-97)**

	(In Percentages)		
	Outstanding Loans (1)	Interest Receipts (2)	Ratio (3)
1974-75	23300	1354	5.81
1975-76	24100	956	3.97
1976-77	25100	794	3.16
1977-78	26600	1327	4.99
1978-79	29600	1755	5.93
1979-80	33187	3797	11.44
1980-81	36182	895	2.47
1981-82	38560	386	1.00
1982-83	40243	1019	2.53
1983-84	43297	951	2.20
1984-85	46290	3060	6.62
1985-86	50504	2410	4.77
1986-87	58273	3835	6.58
1987-88	64900	2609	4.02
1988-89	70780	1794	2.53
1989-90	81400	2142	2.63
1990-91	93100	1949	2.09
1991-92	108400	2310	2.13
1992-93	120070	2760	2.30
1993-94	140120	3776	2.69
1994-95	166400	10032	6.03
1995-96	196700	5621	2.86
1996-97 RE	225040	6144	2.73

Source:

Outstanding loans:- Finance Accounts of Kerala, various issues.

Interest receipts:- RBI Bulletin, various issues.



Table III-7

**Ratio of Revenue Receipts to Revenue Expenditure-(1974-98)**

Years	(In Percentages)			
	Social and Community Services		Economic Services	
	Kerala	All States	Kerala	All States
1974-75	5.6	5.6	49.1	41.8
1975-76	6.1	6.5	46.4	42.6
1976-77	5.9	5.8	48.2	41.4
1977-78	6.2	5.8	49.9	40.1
1978-79	6.4	5.6	45.1	35.7
1979-80	5.1	5.2	52.9	32.7
1980-81	4.7	4.5	39.7	29.0
1981-82	5.4	4.5	39.0	31.7
1982-83	5.4	4.6	43.0	30.8
1983-84	5.6	3.9	25.0	29.8
1984-85	4.3	3.1	22.9	27.2
1985-86	3.4	3.4	24.5	28.2
1986-87	3.5	3.2	21.8	27.0
1987-88	3.4	2.9	20.5	24.9
1988-89	3.1	2.8	17.6	23.4
1989-90	2.8	2.8	16.0	26.6
1990-91	2.4	2.1	13.3	20.6
1991-92	2.3	2.5	15.9	17.7
1992-93	2.4	2.5	15.5	21.3
1993-94	2.4	2.3	19.9	21.7
1994-95	2.2	2.1	21.4	23.8
1995-96	2.6	2.0	21.2	23.0
1996-97 RE	2.1	1.9	15.6	19.8
1997-98 BE	2.1	1.9	10.4	22.6

Note: Revenue receipts from a particular group of services is related to the revenue expenditure on that group of services.

Source: Finances of State Governments", R.B.I. Bulletins.

## CHAPTER IV

### CENTRAL TRANSFERS AND THE FISCAL CRISIS

It was seen in the previous chapter that the State had been relying comparatively more on its own funds to finance its expenditure. In other words, Central budgetary transfers played a relatively smaller role in meeting the State's expenditure. This is brought out more explicitly in Table IV-1. The Table shows that the share of Central transfers in the State's expenditure has been coming down steeply over the years. Besides, except during one year, (1974-75), the proportion of aggregate expenditure as also revenue expenditure financed by Central transfers was lower for Kerala than for All States. But the comparative importance of Central loan transfers in financing the State's capital expenditure varied over the years.

Per capita aggregate Central transfers received by Kerala and All States from the Second Plan onwards are given in Table IV-2. Till 1979-80, as the Table shows, Kerala was receiving per capita Central transfers equal to, or more than the All States average. During 1979-80 and during the Sixth and the Seventh Plan periods, the Central transfers received by Kerala were less than the All States average. The position, however, was reversed during the nineties.

Central transfers according to the three major sources are shown in Table IV- 3. The Table shows that during the Fifth Plan, there was shortfall from All States average only in the non-plan, non-statutory (discretionary) transfers effected by the Union Ministries. All agencies, viz., the Finance Commissions, Planning Commission and the various Union ministries had contributed to the shortfall in Central transfers to Kerala during 1979-80. The biggest shortfall however, was in non-plan, non-statutory transfers. The shortfalls during the Sixth Plan, were mostly in the plan transfers and discretionary

transfers.<sup>1</sup> During the Seventh Plan, all the three categories contributed to the shortfall. During the annual plan period, (1990-92) the shortfall was only in plan transfers. During the Eighth Plan, Kerala received above average transfers from all agencies. Among the three different types of transfers, statutory transfers were less than the average of All States only during 1979-80 and during the Seventh Plan. Plan transfers were lower for Kerala during all periods except the Fifth and the Eighth Plans. As for discretionary transfers, Kerala started getting above average sums only from the nineties.

### **Role of Finance Commissions**

Disaggregation of statutory transfers given in Table IV-4 shows that except during the Fifth Plan period, statutory grants received by Kerala were substantially lower than the All States average. Per capita grants received during the Sixth and the Seventh Plan periods were only marginal. In fact, the Seventh, Eighth and Tenth Finance Commissions had not given any grants at all to Kerala under the substantive provisions of Article 275 of the constitution. With regard to grants for upgradation of social and administrative services too, Kerala received only marginal sums, as may be seen from Table IV-5. Of the total upgradation grants dispensed by the Sixth, Seventh, Eighth and the Ninth Finance Commissions, (First Report) Kerala received only 1.1 per cent.<sup>2</sup> In its second report, the Ninth Commission recommended upgradation grants of only Rs.2.1 crores to Kerala. This formed only 1.3 per cent of the total. The share of Kerala in the total upgradation grants provided by the Tenth Finance Commission was only 2.2 per cent. The State obviously is a victim of its success in attaining above average standards in social and administrative services. At the same time, some of the second generation problems induced by Kerala's very success in attaining higher standards in social and administrative services with serious fiscal implications (See Chapter VI) have clearly escaped the attention of successive Finance Commissions.

The Ninth Finance Commission in its first report had provided Rs.552 crores as grants for solving special problems. Kerala was one of the four states which in the Commission's opinion, did not have

any special problem to merit special grants. Obviously, the Commission had not taken cognisance of Kerala's special problems like massive unemployment of educated youth. It may, perhaps, be that these problems in the Commission's opinion are too massive to be tackled by any special problem grants. May be that the solution to this problem in Commission's view lay in the planning process itself. If this were the Commission's view, it should have left a larger non-plan surplus for the state which would have formed the nucleus of a larger State Plan. Unfortunately, the per-capita non-plan surplus left by the Ninth Commission in its first report was only Rs.35 for Kerala against Rs.106 for All States. The Tenth Finance Commission allotted Rs.50 crores to Kerala for its special problems which was Rs.50 crores less than what was given to Maharashtra.

As may be seen from Table IV-4, shortfall in Kerala's statutory transfers took place not only in statutory grants, but also in tax sharing. Kerala received less tax share during the Fifth and the Seventh Plan periods. Of the two major taxes, it was in the sharing of Union Excise duties that Kerala received less than All States average during these plan periods. This was because of the increasingly larger weightage assigned to social backwardness by the successive Finance Commissions in their tax sharing formula for Union Excise duties.

It was seen earlier that the State was not receiving Articles 275 grants because of the surpluses in the non-plan account assumed by the Finance Commissions' estimates. But the State actually had continuous deficits on non-plan account, even after additional resource mobilisation ever since 1985-86. It was indicated earlier that at least part of the blame for this situation may have to be borne by the unrealistic forecasts of the Finance Commissions.<sup>3</sup>

The Non-Plan deficits/surpluses assumed by the Sixth Finance Commission onwards and the actuals are given in Table IV-6. The Table shows that the actual Non-Plan revenue deficits of Kerala, before and after devolution, were lower than those assumed by the Sixth Finance Commission. (This was true of All States too.) As for the Seventh Commission's forecast for Kerala, actual deficits before devolution were lower than those forecasted. Besides, the actual



surplus after devolution exceeded their estimate. It was during the award period of the Eighth Commission (1984-89) that the volume of actual deficits, before devolution turned out to be far bigger than its forecasts despite the effects of massive resource mobilisation made during the Seventh Plan. This was true not only for Kerala, but also for All States. The surplus after devolution forecasted by them turned out to be deficits in the case of Kerala. For All States, there were surpluses after devolution, but they turned out to be only a fraction (7.4 per cent) of the surpluses assumed by the Finance Commission.

There were substantial divergences between the non-plan deficits for 1989-90 assumed by the Ninth Finance Commission in its First Report and the actuals for the year. The actual non-plan revenue deficits before devolution exceeded the deficits assumed by the Commission by a wide margin. The surplus of Rs.90 crores after devolution forecasted for Kerala turned out to be a deficit of Rs.117 crores even after taking into account the effects of additional resource mobilisation in 1989-90. (In the case of All States too, there was a deficit of Rs. 456 crores instead of a surplus of Rs. 6218 crores). The same pattern of divergence between the forecasts and actuals was noticed during the award periods of the Ninth Commission (Second Report) and the Tenth Commission.

As to where exactly the divergence between the projections and actuals had been taking place, Bajaj and Viswanathan found that "clearly it is easier to remain close to Finance Commission's projections of receipts than of expenditure".<sup>4</sup> This observation was on the Eighth Finance Commission's projections. According to Bajaj and Viswanathan, Kerala's total revenue receipts at current prices exceeded the Eighth Finance Commission's projections during the first four years of the Seventh Plan. Though there were negative variations in case of non-tax revenues, these were more than offset by the large positive variations in the case of tax revenues. Thus, the reason for the large variance in the surplus after devolution amounting to Rs.1050 crores in the case of Kerala can be traced to the large deviations in revenue expenditure from what was assumed by the Eighth Finance Commission. The deviation in expenditure ranged from 24 percent in 1985-86 to 34 per cent in 1988-89.

Such deviation in expenditure took place not only in the case of Kerala but also in the case of other states. But the degree of deviations was much larger for Kerala than for most other states during the Eighth Commission's award period. During 1989-90, the period of the Ninth Finance Commission's first award, despite Reserve's Bank's suspension of treasury payments in December 1987 and the State government's own treasury control since then, there was a deviation (8.5 per cent) between State's budgeted non-plan expenditure and the forecasted expenditure of the Commission.

Bajaj and Viswanathan had tried to identify the possible reasons for the differences in degrees of divergence between projections of receipts and expenditure, "Since the Commission's forecasting (of revenue) was directly based on relevant past experience, the degree of accuracy in prediction was naturally higher. But when we look at the expenditure side, where norms were actually applied and value judgments made, the divergence from the Commission's assumptions is quite substantial". This is particularly true of Kerala. In applying norms and making value judgments on Kerala's non-plan expenditure, particularly non-plan revenue expenditure, Finance Commissions had shown little appreciation of the peculiarities of the pattern of Kerala's expenditure which make the share of revenue expenditure, particularly non-plan revenue expenditure higher. Nor have they appreciated the implications of the higher share of compensation for employees in State's budget arising out of its peculiar pattern of expenditure favouring social services. (See Chapter V)

The Eighth Finance Commission scaled down Kerala's forecast of its non-plan expenditure by 21.4 per cent. But as brought out by Bajaj and Viswanathan, Kerala's actual non-plan revenue expenditure during the first four years of the Seventh plan exceeded Finance Commission's projections by wide margins (24.0 to 33.9 per cent). (This was of course true of most of the states too.) But they have not gone into the reasons why the Commission's projections turned out to be much lower than the actual, possibly due to the absence of disaggregated data.

The disaggregated analysis of the Eighth Finance Commission's projections of expenditure under major heads for the period 1984-85

to 1988-89 has been attempted in Table IV-7. The Table shows that the Finance Commission's forecast of expenditure even on a head like interest payments had substantially deviated from actuals. As against the Commission's forecast of Rs.435 crores, the actual interest payments amounted to Rs.891 crores (105 percent more than the forecasts). And this was a head where there was very little scope for Commission's value judgments. If only the Commission's projections on interest payments were nearer to the actuals, the non-plan revenue surplus of Rs. 624 crores assumed by the Commission would have been reduced to Rs.168 crores. Divergence between the forecasted and actual expenditure varied from 39.2 per cent in the case of medical services to 43.3 percent in case of education. Finance Commission's projections were relatively closer to actual in the case of Economic Services than in the case of Social and Community Services, though wide margins existed even under Economic Services. If we take into account the total of all non-plan expenditure projected under specific identifiable heads by the Commission, the actuals had overshoot the projection by 48.4 per cent. It should be added that the actuals turned out to be 30.6 per cent higher than even the State's own forecasts, reflecting either the poor forecasting ability of the State or the conservative nature of its forecasts.

It is in respect of forecast of the increase in expenditure on account of upgradation of emoluments that the Eighth Finance Commission had erred substantially. It did not take into account the need for quinquennial pay revision falling due in the State in 1983 and 1988. It had taken 1st April 1982 as the base date for making provisions for upgradation of emoluments. Consequently, the Commission had provided for only Rs.66 crores for upgradation of emoluments for the entire quinquennium beginning with 1984-85. The salary revision commitments on account of Fourth pay Commission Report amounted to Rs. 348 crores for the five year period, 1984-85 to 1988-89. Thus the actual commitments turned out to be almost five times higher than those envisaged.<sup>5</sup> It requires to be emphasised that in spite of the quinquennial salary revisions, as the Eighth and Ninth Finance Commissions have found, the salary levels in the State are not any higher than in other States. In fact, they were

lower and the Eighth Commission had to provide Rs. 62 crores to equate the salary rates in Kerala with those in other states, as on 1st April 1982.

The failure to take into account the need for pay revision during the long seven years period (1982-89) had upset the finances of a state like Kerala more because of the higher proportion of compensation for employees in government's consumption expenditure. It will be argued later in Chapter V that the share of compensation for employees in the State's expenditure is higher in Kerala due to higher share of Social and Community Services in its expenditure. The higher wage bill in total expenditure had made Kerala budgets more vulnerable to increases in Dearness Allowance resulting from the increase in consumer prices. The Eighth Commission assumed Rs.356 crores for D.A. in case of employees and pensioners during the long five year period of its forecast. Actuals turned out to be Rs. 746 crores for four years.<sup>6</sup>

The above critique of the Eighth Finance Commission's estimates of non-plan receipts, expenditure and surpluses are valid for the estimates of other Commissions also. This is particularly true of the assumptions of all Commissions, that the price increases will affect the states' revenue and expenditure equally. The other assumption that price rise will affect all states uniformly is also questionable.

The above discussion leaves one to conclude that one of the important reasons for the fiscal crisis of states, particularly of a state like Kerala is the faulty methodologies used by the successive Finance Commissions in forecasting state governments' revenues and expenditure. As for Kerala, none of the Commissions had been taking into account the special budgetary needs of a recurring nature arising from Kerala's past expenditure priorities in favour of Social and Community Services.

The successive Finance Commissions failed to take cognisance of the State's special problems while fully taking cognisance of State's achievements. As will be argued later in Chapter VII, some of these special problems are second generation problems arising from the very achievements of the State in social development.



### **Central Plan Transfers**

It was noted earlier that it was the Planning Commission's inadequate Central Plan transfers, which accentuated the fiscal crisis of the State from 1979-80 onwards. As may be noted from Table IV-8, Central transfers for financing Kerala's Sixth Plan in per capita terms was only Rs.214 as against Rs. 265 for All States. Even if Central transfers for financing Central and Centrally Sponsored Schemes are included, there was a shortfall of Rs. 51 in Kerala's per capita transfers from the All States average during the Sixth Plan Period. During the Seventh Plan Period, Central transfers received by Kerala for financing its plan was short of All States average by Rs. 60. Transfers for financing Central and Centrally Sponsored Schemes also fell short of All States average though only marginally. During the nineties also, per capita Central transfers received by Kerala for financing its plan was short of All-States average. This shortfall was made up by larger flows under Central and Centrally Sponsored Schemes.

Apart from its inadequacy, the grant-loan composition of Central plan transfers was also unfavourable for Kerala. As may be seen from Table IV-9, the share of grants in Central Plan transfers (for State's Plan, Central and Centrally Sponsored Schemes) was lower for Kerala during twenty out of the twenty four years covered by the present study. As will be seen in the next chapter, the revenue component of Kerala's Plan was higher than that of All States during most of the years.

### **Non-Plan, Non-Statutory Transfers**

During every plan period till the nineties, Kerala received less transfers of this type than All States. One of the major components of transfers of this type is the Small Saving loans. From the Eighth plan onwards, Kerala had been getting above average sums of small savings loans. Per capita Ways and Means Loans received by Kerala was also higher indicating its fiscal distress. But unfortunately, as seen earlier, most of the Finance Commissions have not taken cognisance of this fiscal distress while deciding the quantum of gap grants and debt relief.

## Notes and References

1. They are termed discretionary because they are not governed by any fixed norms or formula unlike in the case of statutory transfers or plan transfers for financing states' Plans.
2. These are conditional grants linked to the attainment of particular objectives.
3. As indicated in chapter II, actual non-plan gaps calculated by us are under estimates and actual surpluses over estimates. While the Finance Commissions' estimates of non-plan revenue are made on the basis of tax and non-tax base and rates prevailing in the year preceding the award period, actual revenue figures taken by us are inclusive of additional revenue mobilised by increasing the rates and widening the base. See footnotes to Table II-4.
4. Bajaj, J.L. and Viswanathan Renuka, "Financial Management in States", *EPW* Oct. 7, 1989.
5. Government of Kerala, *Memorandum to the Tenth Finance Commission*, 1993.
6. Ibid.

**TABLE IV-1**

**Share of Central Transfers in States' Expenditure**  
(In Percentage)

Year	Revenue Expenditure		Capital Expenditure		Total Expenditure	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	30.8	37.3	55.0	42.1	42.0	38.7
1975-76	36.3	40.4	44.4	39.4	38.2	40.1
1976-77	33.9	40.1	51.3	37.8	38.3	39.4
1977-78	36.3	40.9	51.6	44.6	40.3	42.1
1978-79	36.7	42.1	76.0	62.8	45.8	48.9
1979-80	33.5	45.4	41.7	46.2	35.5	45.7
1980-81	30.5	43.4	39.8	41.5	32.6	42.7
1981-82	32.3	40.9	28.2	43.5	31.1	41.7
1982-83	32.6	39.6	50.9	50.5	36.5	42.9
1983-84	33.2	36.7	61.9	51.8	40.2	41.0
1984-85	32.5	37.4	49.2	52.8	37.1	41.8
1985-86	34.5	41.2	81.4	69.2	47.0	48.8
1986-87	31.7	39.9	56.2	56.2	37.4	44.2
1987-88	26.5	39.2	64.2	61.2	34.4	44.6
1988-89	31.6	39.1	62.9	66.9	37.4	45.2
1989-90	27.9	35.9	59.1	68.0	34.3	42.8
1990-91	30.2	37.5	74.1	72.4	37.4	44.9
1991-92	29.3	37.2	72.9	60.1	37.9	41.8
1992-93	31.5	39.9	74.9	56.6	38.6	43.1
1993-94	29.2	39.8	70.5	57.0	36.0	43.1
1994-95	29.0	34.9	84.0	58.1	37.3	39.7
1995-96	25.8	34.5	59.8	60.2	31.2	39.2
1996-97 RE	26.3	35.2	59.9	70.2	31.1	41.3
1997-98 BE	25.9	35.3	77.0	70.0	32.2	32.2

**TABLE IV-2**  
**Per Capita Aggregate Central Transfers,1956-1997**

Plan Periods	Kerala	All States
II	77	77
III	163	129
APs(1966-69)	142	122
IV	306	278
V	489	467
AP(1979-80)	118	151
VI	822	925
VII	1739	1961
APs(1990-92)	935	902
VIII	3577	3458

Source: For all plans upto VII, George K.K. "Centre- State Financial Flows and Inter-States Disparities", Criterion Books, Delhi, 1988, p.53-54. For subsequent periods, calculated by us.

APs refer to the years of plan holidays. These years were covered not by Five Year Plans but by Annual Plans.



TABLE IV-3  
Category-Wise Per Capita Central Transfers-1974-1997

Plan Periods	Statutory Transfers		Plan Transfers		Non-Plan Non-Statutory Transfers		Total Transfers	
	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States
V	253	202	187	185	49	80	489	467
1979-80	64	68	49	54	5	29	118	151
VI	375	370	315	368	132	187	822	925
VII	670	768	750	814	319	379	1739	1961
1990-92	381	372	336	353	218	177	935	902
VIII	1542	1527	1451	1422	584	509	3577	3458

Notes: Plan transfers include transfers for Central and Centrally Sponsored Schemes in addition to transfers for financing states' own Plans.

Table IV-4

## Category Wise Statutory Transfers, (1974-97)

Category	(Rs. per capita)											
	V		VI		VII		1990-92		VIII			
	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States	Kerala	All States
1.Income Tax Share	60	60	16	16	83	177	179	116	94	584	491	
2.Union Excise Share	88	91	48	47	265	475	516	242	232	942	889	
3.Total Tax Share(1+2)	149	153	64	63	349	652	695	358	326	1526	1380	
4.Statutory Grants	104	49	Neg.	5	22	18	73	23	46	16	146	
5.Total Statutory Transfers (3+4)	253	202	64	68	370	670	768	381	372	1542	1527	

Table IV-5

Share of Kerala in Total Upgradation Grants

Service	(In Percentages)				
	VII	Finance Commission VIII	IX	X	
1. Police	2.6	1.4	1.9	2.4	3.5
2. Education	-	-		-	0.7
3. Jail	5.3	0	0.5	0.6	3.4
4. Tribals	-	-	0.5	0.1	-
5. Medical	-	-	2.7	0.4	-
6. Judicial	-	0.5	5.3	5.3	-
7. District & Revenue Administration	1.9	0.6	1.4	0.5	4.5
8. Training			6.4	9.3	-
9. Treasury Administration	-	-	1.8	1.1	-
A. Total Social Service	-	-	0.6	0.1	0.3
B. Total Admin. Service	2.3	1.0	1.9	2.1	1.9
TOTAL (A+B)	0.8	1.0	1.4	1.3	2.2



**Table IV-7**

**Non-Plan Expenditure of Kerala under selected Heads:(1984-89)  
Eighth Finance Commission's Forecasts and Actuals**

(In Crores of Rupees)			
Heads of Accounts	Forecasts	Actuals	Percentage difference between Col.2 & 1
	(1)	(2)	(3)
1. Interest	434.73	890.79	104.91
2. Police	216.56	310.11	43.20
3. Education	1499.50	2148.88	43.31
4. Medical	338.41	471.21	39.24
5. Social Service & Welfare	220.96	314.05	42.13
6. Irrigation	83.73	101.59	21.33
7. Buildings incl. Housing	29.86	32.99	10.48
8. Roads and Bridges	173.50	177.42	2.26
<b>9. Total</b>	<b>2997.25</b>	<b>4447.04</b>	<b>48.37</b>

Source: 1. Report of the Eighth Finance Commission (1984)  
Government of India, Delhi, p.215  
2. Budgets of Government of Kerala

**TABLE IV-8**

**(Per Capita Plan Transfers from the Centre (1974-97))**

Plan Periods	For State Plans		For Central and Centrally Sponsored Schemes			Total
	Kerala	All States	Kerala	All States	Kerala	All States
V	145	143	42	42	187	185
AP	40	41	9	13	49	54
VI	214	265	101	103	315	368
VII	510	570	240	244	750	814
AP	234	246	102	108	336	353
VIII	961	1021	489	401	1451	1422



**TABLE IV-9**  
**Share of Grants in Central Transfers (1974-98)**

(Figures in Percentages)

Year	Plan		Non-Plan		Total	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	34.7	43.8	71.5	61.0	56.0	48.7
1975-76	37.6	43.0	79.9	61.8	58.1	48.5
1976-77	37.1	49.1	86.2	60.0	49.3	51.0
1977-78	37.9	46.1	81.0	62.7	54.1	49.0
1978-79	37.6	47.5	65.9	38.7	47.8	43.4
1979-80	38.2	54.8	21.0	29.3	36.5	43.8
1980-81	42.9	51.1	31.7	38.1	41.2	46.5
1981-82	44.1	54.0	42.5	30.4	43.9	44.7
1982-83	47.0	52.4	14.6	34.3	39.0	44.8
1983-84	52.2	55.0	5.8	30.3	37.5	45.5
1984-85	60.6	55.5	42.8	27.2	57.0	47.2
1985-86	46.5	56.5	68.8	26.8	40.6	42.7
1986-87	45.6	56.3	29.3	30.9	39.5	46.8
1987-88	48.5	55.6	16.5	30.9	40.1	47.1
1988-89	52.0	58.7	18.3	31.7	42.5	49.3
1989-90	47.4	54.9	15.6	26.4	34.6	43.0
1990-91	53.8	61.3	38.2	28.8	47.4	47.5
1991-92	57.0	64.9	14.4	33.2	39.2	53.8
1992-93	59.5	65.7	17.4	37.5	48.8	57.5
1993-94	56.7	67.4	14.6	35.5	45.8	59.4
1994-95	62.5	60.2	9.3	25.0	45.8	51.0
1995-96	55.2	63.3	18.9	35.4	41.7	51.7
1996-97 RE	61.5	60.6	12.1	31.7	50.1	50.9
1997-98 BE	59.5	58.7	14.0	25.6	48.0	49.8

**TABLE IV-10**  
**Category-wise Discretionary Transfers (1974-97)**

Category	V			1979-80			VI			VII			AP			VIII		
	Kerala			Kerala			Kerala			Kerala			Kerala			Kerala		
	All States	Neg		All States	All States		All States	All States		All States	All States		All States	All States		All States	All States	
1. For Natural Calamities	-			-	1	7	9	53	13	16	7	16	17					
2. Other Non-Plan, Non-Statutory Scheme wise Transfers	-			-	-	-	-	15	90	23	33	57	73					
3. Small Savings Loans	11	28		3	10	29	81	159	250	98	125	442	379					
4. Ways & Means Advancements	9	11		-	4	55	27	92	26	81	12	70	34					
5. Loans for Special Schemes	-	-		-	-	-	-	-	-	-	-	-	5					

(Rupees per Capita)

## CHAPTER V

### **PATTERN OF KERALA'S PUBLIC EXPENDITURE**

In this chapter, it is proposed to examine in depth the pattern of Kerala's public expenditure and some of its distinct features. The effects of Kerala model of public expenditure on the State's fiscal crisis are also examined here.

Compared to other states in India, the levels of public expenditure in the State had always been high. The sectoral priorities too had been different. This difference makes its impact felt on all other aspects of the State's budget.

Table V-1 shows the ratio of government expenditure to State domestic product for Kerala and for All States during the 24-year period. This ratio was higher for Kerala during all the years except 1982-83. With the exception of 1974-75, the ratio for Kerala has been above 20 per cent. From 1985-86 onwards, it was always more than 25 per cent.

Break-up of the ratio of budgetary expenditure to state domestic product, shows that the State's ratio of capital expenditure to sdp was lower than that of All States during most of the years while the ratio of revenue expenditure to sdp was consistently higher. In fact, from 1985-86 onwards, the ratio was always above 20 per cent.

In per capita terms also, the total public expenditure of Kerala was higher than that of All States. This is brought out in Table V-2. This Table also brings out that capital expenditure per capita was always lower in the State. The same was the case with per capita plan expenditure of the State (under both revenue and capital accounts). Thus, it is the larger per capita non-plan expenditure, particularly the revenue expenditure of the State that accounts for the higher budgetary expenditure of the State.

## **The Preponderance of Social and Community Services**

The basic difference between the pattern of expenditure of Kerala and of All States lies in the substantially higher share of Social and Community Services in the total expenditure as compared to the share of Economic Services. This difference in priorities in the state's expenditure which led to the making of the Kerala model of development to some extent explains all other differences between the State's budgets and the budgets of All States. This had led to higher revenue content of the state's expenditure. This also explains the higher non-plan component of state's expenditure.

Table V-3 gives the share of Social and Community Services in total expenditure of Kerala and All States. The share of Social and Community Services is higher in both revenue and capital expenditure of Kerala. The difference between Kerala and All States was more in the share of these services under the non-plan account. An important point to note is that All states have overtaken Kerala in the share of these services in their plan expenditure from the nineties. It appears that Kerala is altering its plan priorities with serious implications to its social development.

The share of social services in Kerala's expenditure shows a steady decline not only in plan expenditure but also in total expenditure. The decline in the share of social services in Kerala was mostly under the revenue account. The decline under non-plan account also was pronounced. Within the plan account, there was a sharper decrease under plan revenue account.

The difference between Kerala and All States in the share of social and community services is largely on account of the substantially higher share of education and allied services in Kerala's expenditure, as may be seen from Table V-4. The share of medical and public health services including water supply and sanitation in Kerala too is higher; but the difference has been only marginal. Besides, these differences are narrowing. The share of other social services in Kerala's expenditure was in fact lower than that of All States during the Fifth and the Sixth Plans. During the Seventh Plan,

however, their share in Kerala budgets went above that of All states. However, the difference here too was only marginal.

### **Dominance of Education**

Table V-5 shows the share of education, art, culture and scientific research in the total expenditure of Kerala and All States. It clearly brings out that the share of education and related services in Kerala was substantially higher than that of All States, under both revenue and capital accounts. But the Table also shows that the share of education has been coming down. During the nineties, the share of education in total plan expenditure has been lower than that of All States. The declining share of education in plan expenditure indicates the diminishing priority bestowed to this sector in recent plans.

The higher share of expenditure on Social and Community Service as also non-development expenditure in Kerala's total expenditure implies lower share of Economic Services. This is brought out more explicitly in Table V-6.

The difference between Kerala and All States in respect of the share of economic services in total expenditure is substantial under both revenue and capital accounts. Difference in the share of economic services was present under both plan and non-plan accounts. But from the nineties, the share of these services in the plan account is larger for Kerala than for All States confirming the shift in priorities noted earlier.

### **Larger Revenue Component of Expenditure**

As seen in Chapter II, the origin of Kerala's fiscal crisis lies in its revenue account. This is partly because of the predominance of revenue expenditure in the total expenditure of Kerala. This is brought out more explicitly in Table V-7. The share of revenue expenditure was higher for Kerala than for All States during all the years covered by our study. What is more, this share is steadily increasing. As a result, the share of revenue expenditure is more than four-fifth of the total expenditure from 1988-89 onwards. It may be noted that the revenue content of the non-plan expenditure was considerably higher



than that of plan expenditure during all years, not only for Kerala but also for All States. But the share of non-plan expenditure in Kerala's budgets was higher which boosts its revenue component. What is peculiar about Kerala is the higher revenue content of even its plan expenditure. It may also be noted that the revenue components of both plan and non-plan expenditure are rising. No doubt, this is not a phenomenon peculiar to Kerala. But it is more pronounced in Kerala.

Further disaggregation of expenditure given in Table V-8 shows that the share of revenue expenditure in both the developmental and non-developmental expenditure was increasing in Kerala. This was also true of All States. But the revenue content of Kerala's development expenditure was higher than that of All States except during the Eighth Plan. The revenue content of Kerala's non-developmental expenditure which was lower than that of All States increased during the nineties. Besides, the revenue content of non-development expenditure of Kerala was less than that of development expenditure except during the Eighth Plan.

The reason for the higher revenue content of Kerala's expenditure lies, partly in the dominance of Social and Community Services over Economic Services in its total expenditure. The revenue component of Social and Community Services understandably is higher than that of Economic Services. This is true for Kerala as also for All States. Within the Social and Community Services itself, the share of education and allied services (art, culture and scientific research) with its still larger revenue component was considerably higher in the State. Besides, the revenue content of Kerala's expenditure on economic services was also higher than that of All States, as noted earlier.

### **Larger Non-Plan Component**

It was seen in Chapter II that the State's budgetary problem has its genesis in the non-plan revenue account. As noted in that chapter, there were deficits in non-plan account during recent years even after getting all Statutory transfers and even after using all additional resources mobilised. One main reason for this phenomenon is the

preponderance of non-plan expenditure in Kerala's expenditure, as compared to that of All States. This may be seen from Table V-9. During the entire twenty four-year period, except 1997-98, the share of non-plan expenditure in total expenditure as also revenue expenditure was higher for Kerala than for All States. The non-plan content of capital disbursements was also higher except during five years.

A closer examination of the non-plan content of expenditure under different heads given in Table V-10 shows that it was the non-plan content of development expenditure that was higher in Kerala than in All States. The higher non-plan content of Kerala's development expenditure in turn was on account of the higher non-plan content of expenditure on Social and Community Services (particularly education). In fact, the non-plan content of expenditure on Economic Services was relatively lower in Kerala. As for non-development expenditure, there was very little difference in its non-plan content between Kerala and All States. Almost all the non-development expenditure was of non-plan character.

For the higher ratio of non-plan expenditure to total expenditure in Kerala, the reasons are four-fold. Firstly, the share of the revenue expenditure with its higher non-plan content is higher in the State. Secondly, the Social and Community Services, particularly education, predominate in Kerala's total revenue expenditure. The recurring non-plan content of expenditure on these services is considerably higher than that of Economic Services, not only in Kerala but also in other states. Thirdly, even for Social and Community Services, the non plan component is higher in Kerala than elsewhere because in the past, Kerala had spent more on these service as per its earlier plan priorities. The higher volume of plan expenditure on Social Services in one plan tends to result in correspondingly larger non-plan commitments on that account at the start of the subsequent plan and thereafter. Fourthly, the share of non-development expenditure (almost all of which are non-plan in character) was higher in the State in all Plan periods except the Fifth. Its share in Kerala's expenditure is also increasing.

It was seen earlier that because of the already high level of tax income ratio, it will not be easy for the State to raise more resources by way of taxation in future unless the sdp base itself expands substantially. In this situation, there are only two alternatives before the State for controlling budgetary deficits. The first alternative is to control expenditure and the next is to obtain larger quantum of Central funds.

### **Increasing Share of Non-developmental Expenditure**

Prima facie, non-development expenditure suggests itself as the first target for expenditure control. It may appear at first sight that there is ample scope for cutting non-development expenditure in Kerala as the share of this category of expenditure is higher in the State than elsewhere. Besides, its share has been increasing in the State. As may be noted from Table V-11, the share of non-developmental expenditure has reached 38 per cent of the total expenditure during the nineties. If non-plan expenditure is taken separately, non-development expenditure accounts for nearly half of the total. Non-plan capital disbursements comprise mostly of non-development expenditure, mainly debt servicing payments. More than forty per cent of non-plan revenue expenditure from the nineties is also on non-developmental heads.

Further disaggregation of non-developmental expenditure, however, shows that two out of the three major categories of non-developmental expenditure viz., debt servicing and pension payments are contractual in nature and are therefore not amenable for control, at least in the short run. The only item of non-developmental expenditure that is amenable for some control is the expenditure on public services (Organs of State, Fiscal services and Administrative services).

### **Share of Public Services**

Contrary to popular impression, the share of expenditure on public services (as defined above) in the State has always been lower than that of All States as may be seen from Table V-12. The Table

also shows that the share of public services has been coming down over the years. In per capita terms, the State's expenditure on public services has been lower than that of All states as may be seen from Table V-13. But the Table also shows that per capita expenditure on almost all types of government services-Organ of State, Fiscal Services, and Administrative Services has doubled between the Sixth and the Seventh plans. It more than doubled between the Seventh and the Eighth Plans.

### **Growing Burden of Debt Servicing**

The major item of non-development expenditure in the State is debt-servicing payments. Its share in total expenditure of Kerala and of All States is shown in Table V-14. Table V-15 shows that debt servicing accounted for more than 20 per cent of the non-plan expenditure from the Sixth Plan period. Repayment of principal accounted for as much as 95.6 per cent of non-plan capital disbursements during the Seventh Plan period. The repayment burden seems to have somewhat eased during the Eighth plan. The very high share of debt servicing leaves very little for other expenditure on non-plan capital account.

Outstanding debt of Kerala, in relation to its capacity to service the debt, as indicated by the state domestic product has been one of the highest among states in India as may be seen from Table V-16. Kerala's outstanding debt represented 47.0 per cent of the state domestic product in 1994-95 against 31.5 for 14 major states. Only the two low-income states- Bihar, and Orissa had higher debt-sdp ratios than Kerala. The composition of debt given in Table V-17 shows that Kerala has been relying more on high cost Market Loans, Provident funds, small savings etc. Kerala's reliance on relatively low interest bearing Central loans has been considerably lower than that of All States. This is yet another reason for the higher debt-servicing burden of the State.

All the state governments in India are increasingly getting into debt traps. But the problem of Kerala is much more acute. As may be seen from Table V-18, debt servicing payments took away more than



two thirds of fresh Central loans in case of All States during the Sixth and Seventh plans. In case of Kerala, these payments accounted for as much as 87 per cent of fresh loans during these periods. Debt servicing payments had been more than the fresh loans in case of both Kerala and All States during the nineties. Obviously, the debt relief granted by the Ninth and the Tenth Finance Commissions had been very meagre.

There would have been a reverse flow of loan funds from Kerala to Central Government even during the Fifth and the Sixth Plans. This situation was averted only by the debt relief granted by the Finance Commissions. But the Sixth and the Eighth Commission provided comparatively less debt relief to the State. This may be seen from the lower ratio of debt relief to non-plan capital gaps for Kerala (87 per cent) than for All States (99 per cent) during the five year period ended in 1978-79.<sup>1</sup> During the period 1984-89 covered by the Eighth Finance Commission's award, debt relief formed only 50 per cent of non-plan capital gap of Kerala against 59 percent for All States. The Seventh Finance Commission, however, gave higher proportion of debt relief to the State (73 per cent for Kerala against 61 per cent for All States

The debt relief granted to the State by the Ninth Finance Commission has been only minimal. It was lower than that of other states. Debt relief on Central Government Loans represented only 2.6 per cent of the repayment obligations estimated to have fallen due during 1990-95 in case of Kerala as against 6.3 per cent for All States. Repayment obligations of Kerala even after debt relief on Central loans during 1990-95 was to form 37.2 per cent of loans outstanding at the end of 1988-89 against 26.0 per cent for All States.<sup>2</sup> The Tenth Finance Commission did not provide any general relief to the State as in the Commission's view, Kerala was not a "High Fiscal Distress" state.

It is unlikely that Kerala's debt servicing burden will be lightened in the near future as the root of the problem lies in the massive deficit the state has been incurring year after year. As was seen from Table II-2, increasing proportion of State's revenue expenditure is being



financed by deficits in recent years. It appears that the State is caught in a vicious circle of deficits, debt servicing payments and still more deficits.

### **Growing Share of Pension Payments**

One of the important reasons for the higher share of non-development expenditure in the State's revenue expenditure is the higher share of pension payments. The share of pension payments, largely service pensions, is considerably higher in Kerala than in All States, as may be seen from Table V-19. In fact, it was more than double that of All States. Today, pension payments exceed the current expenditure on all Public Services put together. What is more, the share of pensions is increasing steadily over the plan periods. As a result, pension payments during the Eighth plan period accounted for 11.4 per cent of the total revenue expenditure and 13.5 per cent of the non-plan revenue expenditure.

There are many reasons why the share of pension payments in Kerala is higher. Firstly, the retirement age in the State (55 years) is lower, despite the increasing life expectancy of its people. Secondly, pension commutation rules in the State are more liberal. Thirdly, due to the declining death rate of even people above fifty five years in the State, the number of years for which pension payments are to be made has increased.<sup>3</sup> This is a direct consequence of the Kerala Model on the state budget. Pension payments are likely to pose still more severe problems in future, as life expectancy improves further.

### **Economic Classification of Expenditure**

The dominance of Social and Community services in the State's expenditure implies that the share of consumption expenditure in the State's Final Outlay (expenditure on consumption as well as on capital formation) is quite high. The share of capital formation is correspondingly low.

Table V-20, gives the components of the Final Outlay in the State. The Table shows that the share of consumption expenditure was more than three fourth of the Final Outlay during all but two years. What is more, the share of consumption has been increasing in

the eighties and has reached 91 per cent in 1990-91. On the other hand, the share of gross capital formation has come down from 20.4 per cent in 1975-76 to just 9.1 per cent in 1990-91.

The reasons for the higher share of consumption expenditure are not far to seek. As may be seen from Table V 21, the share of consumption expenditure in the Final Outlay of social services like education and health, understandably, is considerably more than that of economic services. However, the increase in the share of consumption expenditure in Final Outlay was also on account of the steep increase in the share of consumption expenditure in the Final Outlay of Economic Services noticed during the eighties. This, in turn, was a reflection of the increasing revenue component of expenditure not only on social services but also on economic services. (See Table V-8).

Within consumption expenditure, it is the share of compensation for employees that has been very high. It accounted for more than four fifths of the total consumption expenditure in 1990-91. Salaries and pensions to government employees accounted for more than half the State's revenue expenditure and 46.1 percent of its total expenditure. The high share of Social and Community Services in total expenditure of Kerala leads to high share of compensation for employees in its expenditure. The salary and pension bill component of expenditure on Social and Community Services, particularly education is very much higher, for obvious reasons, than that of Economic Services as may be seen from Table V-22. What is more, the share of employees' compensation has been going up steadily under all services including Economic Services. In fact, the increase under economic services has been much sharper.

The popular notion that the state's increasing salary bill is the result of state's expanding public services is a mistaken notion. In fact, it is the Social and Community Services which account for the largest single share in Kerala Government's total compensation bill of employees (see Table V-23). The share of education alone is higher than the share of public services. Thus, it is the personnel in the social and economic service departments that had been largely swelling the

wage bill of the government. And there seems to be little appreciation of this fact by the Finance Commissions and the Planning Commission with adverse consequences to the State's finances.

Our discussion till now brings out not only the fiscal implications of Kerala's expenditure pattern, but also some of its development implications. The contractual obligations like debt servicing and pension payments are larger for the State. This leaves much less for development services. The revenue component of the State's expenditure is much bigger than for other states. More than half the revenue expenditure goes for salaries and pensions, leaving less for provision of current inputs and making capital investments. A large share of both revenue and capital expenditure goes to meet the maintenance expenditure of a recurring nature. This leaves very little for taking new initiatives and for spending on new projects and schemes. The development implication of this aspect of State's public expenditure is discussed in detail in the next chapter.

### **Notes and References**

1. George K.K., Centre-State Financial Flows and Inter-State Disparities, Criterion Books, Delhi 1988, Chapter 8.
2. See Government of India, Second Report of the Ninth Finance Commission, New Delhi, 1989.
3. For all references to the demographic changes in Kerala, see Gulati Leela and Rajan Irudaya *Population Aspects of Aging in Kerala*, Centre for Development studies, Trivandrum. 1988.

**TABLE V-1**

**Ratio of Expenditure to State Domestic Product**

(In percentage)

Year	Total Expenditure		Revenue Expenditure		Capital Expenditure	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	18.0	15.2	13.8	10.6	4.2	4.6
1975-76	20.8	17.8	15.9	12.0	4.9	5.8
1976-77	21.8	18.5	16.2	12.4	5.6	6.1
1977-78	21.8	18.3	16.5	12.4	5.3	5.9
1978-79	22.7	20.3	17.4	13.7	5.3	6.6
1979-80	22.5	21.2	16.9	14.4	5.6	6.8
1980-81	23.8	21.6	18.6	14.8	5.2	6.8
1981-82	29.3	21.9	20.3	15.1	9.0	6.8
1982-83	21.2	22.0	16.7	15.7	4.5	6.3
1983-84	23.8	21.5	18.0	15.4	5.8	6.1
1984-85	24.6	23.2	17.9	16.6	6.7	6.6
1985-86	30.3	25.0	22.2	18.7	8.1	7.2
1986-87	29.4	20.5	22.5	14.6	6.9	5.9
1987-88	27.3	24.6	21.6	18.5	5.7	6.1
1988-89	27.5	23.0	22.4	17.9	5.0	5.1
1989-90	27.1	23.0	21.5	18.0	5.5	5.0
1990-91	27.7	23.3	23.2	18.3	4.5	4.9
1991-92	26.5	23.8	21.3	19.0	5.2	4.8
1992-93	25.4	23.3	21.3	18.8	4.1	4.5
1993-94	26.1	25.5	21.8	18.3	4.3	4.2
1994-95 RE	27.1	23.7	23.0	18.7	4.1	4.8
1995-96 BE	27.9	24.0	23.5	19.6	4.4	4.4

TABLE V-2  
(Per Capita Expenditure (1974-97))

Types of Expenditure	Kerala					ALL STATES						
	V	VI	VII	1990-92	VIII	Total	V	VI	VII	1990-92	VIII	Total
1. Revenue Exp.	181.0	341.0	721.0	1017.1	1772.0	4032.1	149.0	309.0	665.0	945.0	1543.1	3611.1
a. Plan	22.0	61.0	107.0	135.1	284.0	609.1	23.0	63.0	140.0	181.3	281.4	688.7
b. Non-Plan	158.0	280.0	614.0	882.0	1652.1	3586.1	126.0	246.0	517.0	763.6	1261.7	2914.3
2. Capital Exp.	57.0	117.0	195.0	225.8	321.9	916.7	71.0	130.0	213.0	245.6	355.6	1015.2
a. Plan	33.0	73.0	112.0	131.0	216.5	565.5	47.0	84.0	146.0	168.7	246.3	692.0
b.. Non-Plan	24.0	43.0	84.0	94.7	105.4	351.1	24.0	46.0	66.0	76.9	104.1	317.0
3. Total Exp.	238.0	458.0	916.0	1242.7	2093.9	4948.6	155.0	315.0	877.0	1190.6	1898.7	4436.3
a. Plan	55.0	134.0	218.0	266.0	500.5	1173.5	69.0	145.0	293.0	350.1	527.8	1384.9
b. Non Plan	182.0	323.0	698.0	976.7	1757.5	3937.2	87.0	171.0	583.0	840.5	1385.8	3067.3
4. Total Dev. Exp.	169.0	320.0	583.0	724.0	1213.4	3009.4	155.0	315.0	609.0	754.9	1151.1	2985.0
5 Total Non-Dev.Exp.	69.0	137.0	328.0	469.3	788.0	1791.3	63.0	120.0	260.0	365.3	654.8	1463.1



**TABLE V-3**  
**Share of Social & Community Services in Total Expenditure**  
**(1974-97)**

(Figures in percentages)										
PLAN PERIODS										
Types of Expenditure	KERALA					ALL STATES				
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92	VIII
1. Revenue Expenditure	52.4	49.7	46.5	43.5	40.4	39.7	40.8	38.3	37.4	36.1
a. Plan	45.7	38.5	40.3	36.3	36.6	49.5	44.9	40.7	39.3	47.0
b. Non Plan	53.4	52.2	47.4	44.6	41.1	37.9	39.7	37.6	36.9	33.6
2. Capital Expenditure	11.7	17.9	15.5	11.2	14.6	8.8	9.8	11.1	11.2	13.2
a. Plan	16.9	26.7	25.8	16.3	17.9	10.5	13.1	14.4	14.1	16.1
b. Non-Plan	4.6	3.3	1.8	4.0	7.7	5.3	3.7	3.6	4.9	7.2
3. Total Expenditure	42.6	41.6	39.9	37.6	36.4	29.8	31.6	31.7	32.0	31.8
a. Plan	28.6	32.1	32.9	26.5	28.5	23.3	26.8	27.7	27.1	32.6
b. Non-Plan	46.9	45.6	42.9	40.7	38.9	32.8	34.0	33.0	34.0	31.9

TABLE V-4

## Share of Different Social and Community Services in Total Expenditure

PLAN PERIODS											(Figures in percentages)
Types of Expenditure	KERALA					ALL STATES					
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92	VIII	
1. Education	27.4	24.1	22.2	22.3	21.9	15.5	15.0	15.9	16.6	16.3	
2. Medical	9.0	9.8	8.8	8.0	6.9	7.2	8.0	7.8	7.3	6.9	
3. Housing	1.1	1.0	0.7	0.7	0.8	1.2	1.1	1.1	0.9	0.9	
4. Labour & Employment	0.7	1.1	1.2	0.9	0.7	0.5	0.7	0.5	0.5	0.4	
5. Social Security & Welfare	2.7	4.2	3.8	2.0	1.6	2.5	3.9	3.7	1.6	1.6	
6. Other Social Services	1.6	1.3	3.1	3.7	4.5	2.9	2.9	2.7	5.1	6.3	
7. TOTAL (1-6)	42.6	41.6	39.9	37.6	36.4	29.8	31.6	31.7	32.0	31.8	

**TABLE V-5**  
**Share of Education, Art, Culture & Scientific Research in**  
**Total Expenditure (1974-97)**

(Figures in percentages)

Types of Expenditure	PLAN PERIODS									
	KERALA					ALL STATES				
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92	VIII
1. Revenue Expenditure	35.5	31.9	27.9	26.7	28.2	22.6	21.1	20.7	20.6	19.7
a. Plan	21.9	15.1	11.9	6.0	8.3	15.1	9.6	10.1	9.1	15.3
b. Non Plan	37.5	35.5	30.7	29.8	28.9	24.0	24.0	23.6	23.4	21.3
2. Capital Expenditure	1.7	1.5	1.2	2.8	2.7	0.4	0.5	1.0	1.4	1.3
a. Plan	3.0	2.4	2.0	4.8	4.0	0.6	0.7	1.4	2.0	1.9
b. Non-Plan	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
3. Total Expenditure	27.4	24.1	22.2	22.3	21.9	15.5	15.0	15.9	16.6	16.3
a. Plan	10.6	8.2	6.9	5.4	6.2	5.4	4.5	5.8	5.7	8.4
b. Non-Plan	32.5	30.7	27.0	26.9	27.0	20.2	20.2	20.9	21.2	19.7

**TABLE V-6**  
**Share of Economic Services in Total Expenditure (1974-97)**

Types of Expenditure	PLAN PERIODS										(Figures in percentages)
	KERALA					ALL STATES					
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92	VIII	
1. Revenue Expenditure	20.3	22.1	19.0	18.9	19.6	28.9	30.1	30.2	30.6	27.0	
a. Plan	49.5	58.0	58.9	63.7	63.3	48.0	53.6	56.7	58.9	51.0	
b. Non Plan	16.1	14.3	12.0	12.1	11.2	25.4	24.1	22.6	23.8	21.6	
2. Capital Expenditure	54.2	46.3	42.7	51.3	59.5	66.1	64.4	61.4	63.3	63.1	
a. Plan	81.1	71.1	71.8	81.9	82.5	88.4	85.5	80.3	82.9	80.7	
b. Non-Plan	17.6	4.7	3.8	9.0	12.8	22.1	26.1	19.2	20.4	22.7	
3. Total Expenditure	28.4	28.3	24.0	24.8	25.7	40.8	40.3	37.7	37.3	33.7	
a. Plan	68.3	65.1	65.5	72.7	71.6	75.2	71.8	68.5	70.5	64.9	
b. Non-Plan	16.3	13.0	11.0	11.8	11.3	24.9	24.4	22.3	23.5	21.7	

**TABLE V-7**  
**Share of Revenue Expenditure in Total Expenditure**

Year	(In percentage)					
	Non-Plan		Plan		Total	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	85.0	84.6	34.1	29.5	76.4	70.3
1975-76	85.6	81.9	30.0	31.2	76.5	67.9
1976-77	83.9	84.3	41.4	33.0	74.4	67.5
1977-78	90.1	85.3	39.0	31.7	75.6	67.5
1978-79	89.1	84.7	45.1	35.5	76.8	67.1
1979-80	88.9	85.2	36.0	33.6	75.2	67.6
1980-81	92.9	81.6	46.0	37.8	78.0	67.0
1981-82	79.4	84.2	42.9	38.2	69.5	68.8
1982-83	91.3	86.5	44.4	41.0	78.6	71.2
1983-84	90.6	85.4	44.8	44.9	75.5	71.5
1984-85	81.9	82.1	48.2	48.4	72.4	71.6
1985-86	82.5	85.0	43.6	46.6	73.4	73.0
1986-87	88.1	86.7	41.2	48.5	76.5	73.6
1987-88	88.3	88.7	49.1	50.6	79.1	75.3
1988-89	89.3	90.0	56.1	53.2	81.8	77.9
1989-90	89.5	90.6	47.0	50.5	79.5	78.4
1990-91	93.0	90.2	51.6	52.4	83.7	78.8
1991-92	88.1	91.4	50.0	51.3	80.3	79.9
1992-93	90.3	90.9	58.9	54.2	83.4	80.6
1993-94	92.4	91.6	53.7	53.7	83.6	81.2
1994-95	94.8	92.5	53.8	49.7	85.0	79.5
1995-96	93.3	92.8	55.3	51.9	84.2	81.7
1996-97 RE	94.7	93.3	60.4	56.4	85.8	82.7
1997-98 BE	95.4	93.7	69.4	55.1	87.7	82.0

Source: Finances of State Government, R.B.I. Bulletin(s)



TABLE V-8

## Share of Revenue Expenditure(1974-1997)

(Figures in Percentage)

Types of Expenditure	KERALA					ALL STATES			
	PLAN PERIODS								
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92 VIII
1. Plan Expenditure	40.5	45.5	48.9	50.8	56.7	32.7	42.9	50.3	51.8 53.3
2. Non-Plan Expenditure	86.7	86.5	88.0	90.3	93.4	84.2	84.2	88.8	90.0 92.4
3. Total Expenditure	75.9	74.5	78.7	81.8	84.6	67.9	70.4	75.9	79.4 81.3
4. Non-Dev. Expenditure	71.5	69.5	74.5	81.3	90.0	71.8	71.9	77.6	71.1 78.3
5. Debt Services	49.8	44.2	50.9	63.0	79.6	51.6	50.3	60.7	68.5 76.9
6. Dev.Expenditure (7+8)	77.1	76.5	80.9	87.7	79.9	65.9	69.4	74.8	85.1 84.5
7. Economic Services	54.1	58.2	62.7	62.4	64.4	48.0	52.6	60.8	57.4 64.9
8. Social & Comm. Services	93.4	89.0	91.7	94.0	93.9	90.5	90.8	91.5	92.8 92.2
Of which									
9. Education, Art,Culture	98.5	98.4	98.9	97.7	98.2	99.1	99.1	98.5	98.3 98.5
Sc.Research									
10.Net Expenditure	80.4	79.9	86.5	70.1	71.5	70.7	73.5	78.9	69.9 66.6

Source: Finances of State Governments, R.B.I. Bulletin(s)

Note: Net Expendddditure = Total Expenditure-Debt Servicing.

**TABLE V-9**  
**Share of Non-Plan Expenditure in Total Expenditure**

Year	(In percentage)					
	Non-Plan		Plan		Total	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	92.5	89.1	59.9	38.2	83.1	74.0
1975-76	90.9	87.4	49.5	40.9	81.1	72.5
1976-77	87.6	84.0	48.9	32.5	77.6	67.2
1977-78	86.0	84.5	32.5	30.3	73.0	66.9
1978-79	83.5	81.2	34.0	30.1	72.0	64.4
1979-80	85.7	83.1	23.0	30.1	70.1	65.9
1980-81	81.3	81.2	22.1	37.2	68.3	66.7
1981-82	83.3	81.3	49.4	33.6	73.0	66.4
1982-83	84.7	80.7	29.6	31.2	73.0	66.4
1983-84	80.4	78.4	25.8	33.8	67.0	65.8
1984-85	81.3	77.8	47.2	40.4	71.9	67.2
1985-86	86.1	80.1	50.4	38.2	76.6	68.8
1986-87	86.7	77.3	38.1	33.0	75.3	65.6
1987-88	85.4	76.3	42.9	29.7	76.6	64.8
1988-89	84.4	77.5	45.3	30.2	77.3	67.0
1989-90	86.2	80.5	39.1	30.5	76.5	69.7
1990-91	86.1	80.0	33.4	32.4	77.5	69.9
1991-92	87.3	81.5	47.9	30.3	79.5	71.2
1992-93	85.5	81.2	47.7	33.9	79.4	72.0
1993-94	85.3	82.0	35.6	32.7	77.2	72.7
1994-95	85.0	82.8	26.6	25.9	76.2	71.7
1995-96	84.2	82.6	32.0	28.5	75.9	72.7
1996-97 RE	81.6	80.5	27.3	27.7	73.9	71.3
1997-98 BE	76.6	81.4	26.6	26.6	70.4	72.0

Source: Finances of State Governments, R.B.I. Bulletin(s)

**TABLE V-10**  
**Share of Non-Plan Expenditure**

Types of Expenditure	(Figures in Percentage)									
	KERALA					ALL STATES				
	PLAN PERIODS					PLAN PERIODS				
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92	VIII
1. Rev. Expenditure	87.6	82.1	85.2	86.7	84.0	84.7	69.6	77.8	80.8	81.4
2. Cap. Expenditure	42.4	37.4	42.9	42.0	32.7	33.6	35.5	31.0	31.3	29.3
3. Total Expenditure	76.7	70.7	76.2	78.6	76.1	68.3	66.5	66.5	70.6	71.9
4. Non.Dev.Expenditure	97.5	97.2	99.0	83.3	83.3	98.3	98.3	95.5	97.7	97.3
5. Dev.Expenditure	68.2	59.2	63.1	69.0	64.2	55.8	54.1	53.7	61.9	61.2
a. Economic Services	44.0	32.5	35.1	37.3	35.3	41.6	40.3	39.2	45.3	46.4
b. Social & Comm.										
Services (of which)	84.4	77.4	80.3	85.0	81.4	75.2	71.6	70.8	75.1	71.5
Education, Art, Culture,	91.0	90.0	92.6	94.8	84.7	89.0	89.9	87.7	90.0	87.0
6. Net Expenditure	72.7	65.4	71.0	74.0	71.3	62.8	61.3	61.5	65.6	66.8

TABLE V-11

## Plan-wise Share of Non-Development Expenditure

Types of Expenditure	(Figures in Percentage)									
	KERALA				ALL STATES					
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92	VIII
1. Revenue Expenditure	27.2	28.0	33.8	37.6	40.0	30.2	27.9	30.4	32.0	37.0
2. Capital Expenditure	34.2	35.8	42.9	38.9	24.5	25.1	25.8	27.5	25.5	23.7
3. Total Expenditure	28.9	30.0	35.8	37.8	37.6	28.4	27.2	29.7	30.7	34.5
4. Non-Plan Expenditure	36.7	41.3	46.5	47.1	49.1	41.2	40.3	42.7	42.5	46.7
a. Revenue	30.4	33.3	39.6	43.2	47.6	35.3	34.6	38.3	39.2	44.7
b. Capital	77.8	92.0	96.9	88.2	68.9	72.6	70.2	77.3	74.8	70.1

**TABLE V-12****Share of Expenditure on Public Services in Total Expenditure**

Year	(In percentage)					
	Non-Plan		Plan		Total	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	3.6	3.3	14.5	17.8	11.9	13.5
1975-76	3.4	4.0	13.6	17.2	11.2	12.9
1976-77	3.5	2.8	13.1	17.4	10.6	12.7
1977-78	3.2	2.7	12.9	16.7	10.5	12.1
1978-79	3.3	2.4	12.3	15.3	10.2	11.1
1979-80	2.9	2.9	12.9	16.0	10.4	11.7
1980-81	3.5	2.8	11.5	15.6	9.7	11.4
1981-82	2.5	3.0	12.0	15.4	9.1	11.6
1982-83	3.5	3.1	12.9	15.1	10.9	11.6
1983-84	2.7	3.4	11.6	14.8	9.4	11.5
1984-85	2.3	2.9	11.1	14.6	8.7	11.3
1985-86	2.5	2.7	10.5	14.3	8.4	11.2
1986-87	3.0	3.6	11.6	13.0	9.6	10.6
1987-88	1.6	3.2	11.4	12.8	9.3	10.4
1988-89	1.8	3.0	11.3	12.8	9.5	10.7
1989-90	1.2	2.5	11.7	13.7	9.6	11.3
1990-91	1.7	2.4	11.1	13.0	10.2	10.7
1991-92	1.1	2.2	10.8	12.4	8.9	10.4
1992-93	1.8	2.6	9.9	12.9	8.6	10.9
1993-94	1.8	2.6	10.2	12.6	8.8	10.8
1994-95	2.1	3.2	10.7	12.6	9.4	10.7
1995-96	2.6	3.6	10.6	12.7	9.3	11.0
1996-97 RE	3.2	4.2	10.1	12.2	9.2	10.8
1997-98 BE	4.9	3.3	9.5	14.6	8.9	12.6

Notes: Public Services include:

(1) Organs of State; (2) Fiscal Services and (3) Administrative Services.



TABLE V-13

## Per Capita Revenue Expenditure on Public Services

Services	(Figures in Percentage)									
	PLAN PERIODS									
	KERALA					ALL STATES				
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92	VIII
1. Organs of State	2.4	4.1	8.3	12.8	20.7	1.9	3.5	6.7	9.9	18.5
2. Fiscal Services	6.3	10.9	20.6	29.1	51.7	6.8	11.1	16.1	21.2	33.6
3. Administrative Services	15.0	25.2	50.8	69.4	110.5	16.2	31.7	70.9	88.7	144.1
Of which:										
a. District Administration	1.2	2.1	4.0	5.7	8.5	2.1	3.7	7.6	10.2	15.2
b. Police	8.4	14.6	27.5	37.8	63.0	9.0	17.9	35.5	50.6	85.7
c. Public Works	1.1	0.5	3.7	4.5	6.7	1.2	2.9	6.3	9.5	15.3
d. Secretariat General Services	1.0	1.7	3.0	4.1	6.5	0.7	1.2	8.6	3.4	6.6
e. Others	3.3	6.3	12.7	17.3	25.8	3.2	5.9	12.8	15.0	21.3
Total(1-3)	23.8	40.1	79.7	111.3	182.8	24.9	46.4	93.8	119.8	196.1

**TABLE V-14**  
**Share of Debt Servicing in Total Expenditure**

(Figures in percentage)

Year	Capital		Revenue		Total	
	Kerala	All States	Kerala	All States	Kerala	All States
1974-75	29.3	24.6	9.9	11.2	14.6	15.2
1975-76	34.2	24.2	9.6	11.9	15.4	15.8
1976-77	39.5	22.3	9.7	11.3	17.3	14.9
1977-78	26.4	22.2	10.1	11.0	14.1	14.6
1978-79	25.2	19.4	9.2	10.8	12.9	13.6
1979-80	12.7	16.7	9.0	8.9	9.9	11.4
1980-81	13.6	22.5	7.3	9.4	8.7	13.7
1981-82	47.4	21.5	7.9	9.6	20.0	13.3
1982-83	22.8	20.1	8.1	9.6	11.3	14.6
1983-84	20.6	22.3	9.4	9.5	12.2	13.1
1984-85	44.7	26.1	10.8	10.1	20.1	14.6
1985-86	49.1	25.8	8.8	10.3	19.5	14.5
1986-87	36.8	24.9	10.7	11.6	16.8	15.0
1987-88	42.3	24.5	12.0	11.7	18.3	14.8
1988-89	41.2	24.6	11.9	12.1	17.2	14.9
1989-90	36.9	22.8	12.7	12.7	17.7	14.9
1990-91	28.5	22.4	12.1	12.9	14.7	14.9
1991-92	41.5	23.8	15.0	13.3	20.2	15.4
1992-93	41.3	23.5	14.8	14.4	19.1	16.2
1993-94	29.3	24.0	16.0	15.1	18.2	16.8
1994-95	17.7	19.2	16.2	15.8	16.4	16.5
1995-96	15.0	18.0	15.9	15.9	15.7	16.2
1996-97 RE	15.4	18.9	15.1	16.1	15.2	16.6
1997-98 BE	20.2	17.9	15.0	17.1	15.6	17.2

**TABLE V-15**  
**Share of Debt Servicing - Plan-wise**

(Figures in Percentage)

Services	KERALA								ALL STATES			
	V	VI	VII	1990-92	VIII	V	VI	VII	1990-92	VIII	VII	VIII
1. Revenue Expenditure	9.7	9.0	11.5	13.6	15.6	11.2	9.7	12.0	13.1	15.6		
2. Capital Expenditure	30.8	33.0	41.0	36.2	21.1	22.1	22.7	24.4	23.2	20.3		
3. Total Expenditure	14.8	15.1	17.8	17.7	16.6	14.7	13.6	15.0	15.2	16.5		
4. Non-Plan Expenditure	19.3	21.4	23.4	23.2	22.8	21.5	20.4	21.7	21.2	22.4		
a. Revenue	11.1	10.9	13.5	15.7	18.6	13.2	12.2	15.4	16.2	19.0		
b. Capital	72.6	88.4	95.6	93.2	71.8	66.0	64.0	71.9	71.0	63.9		

**TABLE V-16**  
**Ratio of Debt to State Domestic Product**

\* (Figures in Percentages)

States	Ratio
Andhra Pradesh	27.8
Bihar	47.6
Gujarat	26.0
Haryana	27.1
Karnataka	26.1
Kerala	47.0
Madhya Pradesh	29.7
Maharashtra	16.6
Orissa	52.1
Punjab	41.9
Rajasthan	42.0
Tamil Nadu	25.3
Uttar Pradesh	38.7
West Bengal	32.1
Major States(14)	31.5

Note: Debt outstanding at the end of 1994-95 is related to the sdp of that year.

Source: 1. "Report on Currency and Finance", R.B.I., for data on debt.

**TABLE V-17**  
**State-wise Composition of Outstanding Liabilities**

As at the end of March 1997  
(Budget Estimates)

	Internal Debt	Loans and Advances from Central Govt.	Provident Fund etc.	Total Debt (1+2+3)
	1	2	3	4
Andhra Pradesh	4842 (27.71)	10876 (62.24)	1754 (10.03)	17472 (100.00)
Assam	1292 (23.08)	3867 (69.10)	437 (7.80)	5596 (100.00)
Bihar	4116 (22.00)	10848 (57.99)	3740 (19.99)	18704 (100.00)
Gujarat	1874 (14.77)	9375 (73.92)	1433 (11.29)	12682 (100.00)
Haryana	1255 (19.72)	3763 (59.12)	1346 (21.15)	6364 (100.00)
Karnataka	2353 (20.77)	6886 (60.80)	2085 (18.41)	11324 (100.00)
<b>Kerala</b>	<b>3040 (25.78)</b>	<b>4735 (40.16)</b>	<b>4013 (34.04)</b>	<b>11788 (100.00)</b>
Madhya Pradesh	2653 (19.05)	6472 (46.48)	4797 (34.45)	13922 (100.00)
Maharashtra	3231 (15.24)	15302 (72.22)	2654 (12.52)	21187 (100.00)
Orissa	3056 (28.36)	5137 (47.68)	2579 (23.94)	10772 (100.00)
Punjab	1841 (11.85)	11609 (74.75)	2080 (13.39)	15530 (100.00)
Rajasthan	3184 (22.71)	7220 (51.50)	3615 (25.78)	14019 (100.00)
Tamilnadu	3532 (24.11)	9026 (61.62)	2088 (14.25)	14646 (100.00)
Uttar Pradesh	7908 (22.66)	22018 (63.10)	4963 (14.22)	34889 (100.00)
West Bengal	3417 (18.35)	13894 (74.63)	1304 (7.00)	18615 (100.00)
<b>All States</b>	<b>47594 (20.87)</b>	<b>141028 (61.35)</b>	<b>39388 (17.27)</b>	<b>228010 (100.00)</b>

Note.1 Figures in brackets indicate percentage to total outstanding debts of respective state Government.

Source: Report on Currency and Finance, 1996-97



**TABLE V-18**  
**Ratio of Debt Servicing Payments to**  
**Gross Loans from the Centre**

(Figures in Percentages)

Plan Periods	Kerala	All States
Fifth	77	67
Annual Plans (1979-80)	56	52
Sixth	87	65
Seventh	87	68
Annual Plans (1990-92)	129	105
Eighth	153	138

TABLE V-19

Share of Pension in Revenue Expenditure-Plan-wise

Category	(Figures in Percentage)												
	KERALA					ALL STATES							
	V	VI	VII	VIII	V	VI	VII	VIII	V	VI			
			1990-92				1990-92				1990-92		VIII
1. Non-Plan Revenue Exp.	5.0	8.8	11.8	12.9	13.5	2.8	4.0	5.5	5.7	6.2			
2. Total Revenue Exp.	4.4	7.3	10.5	11.1	11.4	2.3	3.2	4.3	4.6	5.1			



**TABLE V-21**  
**Share of Consumption and Capital Formation in**  
**Final Outlay of Individual Services**

(Figures in percentages)

Year	Total Consumption Expenditure			Gross Capital Formation		
	Education	Health	Eco. Services	Education	Health	Eco. Services
1975-76	95.1	97.2	44.6	4.9	2.8	55.4
1976-77	94.8	97.5	42.1	5.2	2.5	57.8
1977-78	93.1	97.3	35.8	7.1	2.7	64.2
1978-79	93.3	94.2	25.1	6.7	5.8	74.9
1979-80	94.6	94.1	21.5	5.4	5.9	78.4
1980-81	94.1	94.5	70.1	5.9	5.5	29.9
1981-82	91.3	95.4	69.6	8.7	4.6	30.4
1982-83	95.3	98.2	71.6	4.7	1.8	28.4
1983-84	94.9	105.6	45.0	5.1	-5.6	55.1
1984-85	95.2	96.2	74.0	4.8	3.8	26.1
1985-86	90.2	93.7	66.0	9.8	6.3	34.1
1986-87	95.7	93.1	68.1	4.3	7.1	31.9
1987-88	97.7	96.4	72.0	2.3	3.6	28.1
1988-89	96.1	95.2	74.6	3.9	4.8	25.4
1989-90	96.9	97.6	71.4	3.1	2.4	28.6
1990-91	95.1	97.8	73.5	4.9	2.2	26.5

Source: Economic cum Functional Classification of Budgets, Government of Kerala.

TABLE V-22

## Share of Compensation for Employees in Total Consumption Expenditure of Kerala

		(In Percentages)										
Services		1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
1. Gen. Public Services		74.3	74.0	78.4	78.7	78.7	79.1	81.0	81.2	84.1	82.2	83.7
2. Soc. & Comm. Services		78.1	75.9	75.9	79.2	80.8	82.4	80.6	84.4	85.1	83.0	81.6
Of which												
(a) Education		85.4	88.1	89.8	89.9	90.5	90.9	89.8	92.0	92.8	89.8	93.4
(b) Health		62.1	61.6	47.0	65.3	66.3	70.9	72.2	73.5	73.4	73.1	75.5
3. Economic Services		36.7	42.0	47.0	45.1	55.8	53.3	53.2	58.5	53.4	56.9	60.8
Total		68.0	67.8	71.2	73.3	75.0	77.4	77.5	79.3	79.5	79.0	81.4

Source: Economic cum Functional Classification of Budget.

Bureau of Economics and Statistics, Government of Kerala.



**TABLE V-23**  
**Share of Individual Services in Total Compensation for Employees in Kerala**

Services	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
1. Gen. Public Services	26.6	27.8	30.7	30.6	28.5	28.6	28.7	29.1	28.6	28.3	28.3
2. Soc.& Comm. Services	60.5	58.3	57.5	59.0	61.0	60.8	59.9	58.3	59.8	60.1	58.5
Of which											
(a) Education	33.5	35.3	39.1	37.8	35.7	35.7	36.1	34.7	35.0	36.4	34.5
3. Economic Services	11.9	13.9	11.8	10.4	10.5	10.4	11.4	12.6	11.6	11.6	12.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Economic cum Functional Classification of Budget.

Bureau of Economics and Statistics, Government of Kerala.

## CHAPTER VI

### **FISCAL CRISIS AND THE STATE'S DEVELOPMENT CRISIS**

Kerala's fiscal crisis is steadily eroding its capacity to finance development expenditure, on a large scale thus reinforcing the state's development crisis. As may be seen from Table VI-1, there was deceleration in growth of the State's plan expenditure financed through the budget, in the eighties. Total plan expenditure (including expenditure on Central and Centrally Sponsored Schemes) registered actual decline in 1982-83 and 1987-88. During the Seventh Plan, capital component of the total plan expenditure declined by 6.4 per cent during 1988-89 on top of the decline of 14.5 per cent during 1987-88. During the nineties, capital plan expenditure showed an absolute decline of 9.9 per cent during 1992-93. However, the above trends are reversed during later years.

As may be seen from Table VI-2, per capita State plan outlay of Kerala was equal to that of All States during the Second Plan Period. The relative position of the State in this respect improved during the Third, Fourth and the Annual Plan periods. From the Fifth Plan onwards, Kerala's per capita State plan outlay turned out to be less than the All States average, that too by a considerable margin.<sup>1</sup> But the position is reversed during the Eighth Plan. Even then, the margin of difference between Kerala and some of the high-income states continues to widen. Kerala's per capita plan outlays were less than half that of Haryana during the Fifth and the Seventh Plans. During the Sixth Plan, it was only 50 per cent. Even during the Eighth Plan, Kerala's per capita plan outlay was only 73 percent that of Haryana.

Identification of the reasons for the decline in the relative size of the State's plan outlays requires an examination of the process of plan formulation in states. From 1969-70 onwards, the amount of Central plan transfers is decided first. The States' plan outlays are then determined by the own revenue and capital resources that can be

mobilised for the plan by the states. Plan transfers to each state are largely determined by the Gadgil formula.<sup>2</sup> Some plan transfers on account of external project assistance are effected outside the formula. Central transfers for development of hill areas, tribal areas, border areas and special problem areas are also kept outside the Gadgil formula.

No doubt, the Gadgil formula for allocation of plan funds among states with its 20 per cent weightage to per capita income of those states having below the All States average per capita income was meant to help the low income states like Kerala. But, it has not actually helped Kerala from 1979-80 onwards as was seen from Table. IV.3. Per capita plan transfers to Kerala during the Sixth Plan were only 81 per cent of the All States Average. As for transfers for Central and Centrally Sponsored Schemes, Kerala had managed to get amounts, which are equal to All States average during the Fifth Plan. There were short falls, though only marginal, during subsequent plan periods. The position however was reversed during the Eighth Plan.

The reasons for the shortfall in plan transfers for state plans, despite the apparent progressiveness of the Gadgil formula are not clear in the absence of disaggregated data on Central plan transfers. It may possibly be due to the weightage of 10 per cent given to special problems in the Gadgil formula that has deprived the State of even average quantum of Central plan transfers. It may also be possible that large volume of plan funds continue to be distributed among states outside the Gadgil formula in the name of development of hill areas, tribal areas, border areas and special problem areas. Yet another possibility is that transfers on account of external credits had been regressive.<sup>3</sup>

Though Kerala had been receiving only less than average amount of Central plan funds, its dependence on Centre for financing plan outlays had been higher than for All States during most of the plan periods as may be seen from Table VI-3. This high dependence is understandable in view of the continuous non-plan deficits of the State which eat away even some of the additional resources mobilised for the plans as was noted in Chapter II.

The availability of state's own resources for plan financing depends not only on its resource mobilisation efforts, but also on the size of the resource base. We had seen earlier that Kerala's ratio of revenues to state domestic product, particularly of the tax revenue has been one of the highest among the states in India. Due to its efforts, the State had been raising more own revenue per capita, than the All States average. But the volume of its revenue resources had been lower than that of some of the high-income states with much lower resource mobilisation efforts. Obviously, the State's resource base is too small to generate adequate revenue to finance larger plans than at present.

In determining the quantum of internal resources available for plan expenditure (balance on current account), the volume of non-plan expenditure is also a crucial variable. It was noted earlier how the past expenditure priorities of the State in favour of Social and Community Services with its recurrent nature boosts the non-plan expenditure requirements of the State. As was seen in Chapter IV, there was inadequate appreciation of the implication of the special features of Kerala's expenditure by successive Finance Commissions.

Another fact that is often overlooked is that non-plan surpluses of a state also depend on the formulae for devolution, grants and debt relief used by Finance Commissions. Overall surpluses (revenue and capital) left by the Finance Commissions financed 26.4 per cent of All States' Sixth Plan outlays and 31.0 per cent of the Seventh Plan outlays.<sup>4</sup> In the case of Kerala, these surpluses were to finance only 12.4 per cent and 27.3 per cent of the Sixth and Seventh Plan outlays. As may be seen from Table VI-4, Kerala was left with no revenue surplus by the Fourth, Fifth and the Sixth Finance Commissions. The per capita revenue surplus left by the Seventh Commission was only 45 per cent of the All States average. The surplus left by the Eighth Finance Commission was relatively larger. But it still formed only two thirds of the All States average. The first report of the Ninth Finance Commission allowed a per capita revenue surplus of just Rs. 35 to Kerala against Rs.106 for All States. In its second report, the Commission left a non-plan revenue deficit of Rs.162 per capita. The



per capita non-plan revenue surplus for Kerala by the Tenth Finance Commission was, however, higher than the All States average.

As seen earlier, non-plan surpluses assumed by the Finance Commissions had been turning out to be deficits. This has led to the State utilising even additional resources mobilised for meeting non-plan expenditure. Besides, the State because of its better social development had not received much upgradation grants and special problem grants.

As for capital resources for Plan, Kerala had been getting inadequate quantum of Small Savings Loans from the Centre. As was seen in Chapter IV, Small Saving Loans to Kerala formed just 55 per cent of All States average during the period, 1974-1990. The position changed for the better only during the Eighth Plan.

As mentioned earlier, the State is caught in a vicious circle. Because of the small size of sdp, the State, despite larger resource mobilisation efforts has not been able to generate own funds adequate to finance larger plans as well as higher levels of non-plan expenditure. The Central plan transfers too had been mostly below the All States average.

A major policy change is now called for if Kerala as also other backward states are to get out of this vicious circle. The first, though inadequate step will be to change the present pattern of determining the size of the State plan Outlays. Instead of Gadgil formula being applied to Central Plan transfers as at present, it should logically be applied to determine the size of the states' plans. The gap between such objectively and equitably determined plan outlays and the normatively determined states' own resources should be met by Central Plan transfers and by increased allocation of Small Savings Loans, Market Loans and Institutional Loans.

The changes suggested above call for a return to the pre 1969 pattern of determining first the states' plan outlays and then the Central plan transfers. The criticism in 1969 of the then prevailing system was that plan outlays were not determined either objectively or



equitably. The application of an objective formula like the Gadgil formula with some progressive features, however, small they may be, will meet the first criticism. To quote Gadgil, himself. “.... there is a lot of discussion on regional backwardness. Yet, about the basic problem of plan outlays in a federal polity, there is very little thinking. But I think it is important that there is a debate, a much wider debate than at present on these questions”.<sup>5</sup> The changes suggested above may appear to be too radical. But this is the minimum change that is required if states like Kerala are to get out of the present vicious circle of low economic growth and fiscal crisis, reinforcing each other as at present.

### **Kerala and Central Plan Investments**

The decline in the relative volume of State's plan expenditure is only one of the many factors that has led to the present development crisis of the State. The low level of Centre's direct plan expenditure in the State is another major causative factor. During the first three decades of planning in India, Kerala received in per capita terms only Rs.241 of the identifiable Central plan outlays against Rs.350 for all states.<sup>6</sup> Similar data for subsequent period are not available. What little data available are, on the value of Gross Block of Central Public Sector Undertakings. These data show that Kerala's share in Central Public Sector investment has been coming down steadily. It has come down from the already low figure of 3.1 per cent at the end of March 1970 to 1.3 per cent at the end of March 1995.<sup>7</sup> On the other hand, already developed states like Maharashtra bettered their position from 4.1 per cent to 17.6 per cent. The per capita investment of 'the Central government in the post economic liberalisation period in Kerala was just Rs.619 against the All India average of Rs.1117.<sup>8</sup> Thus states like Kerala which could not afford large States Plan Outlays due to resource constraints did not benefit from Central government's investments either. The low public investment on infrastructure and industry by the State and the Centre has made Kerala unattractive for private sector investment.

## Notes and References

1. See George K.K., *Centre-State Financial Flows and Inter-State Disparities in India*, Criterion Books, Delhi, 1988.
2. For details, see Ramalingam R. and Kurup K.N., "Plan Transfers to States - Revised Gadgil Formula: An Analysis", *EPW*, March 2, 1991.
3. See, George K.K. op. cit.
4. Gulati I.S. and George K.K., "Eighth Finance Commission's Award", *EPW* July 25, 1987.
5. Gadgil D.R., "Some Aspects of Centre-State Financial Relations", in Kamat, A.R. (ed) *Planning and Development, 1967-77*, Gokhale Institute of Politics and Economics, Pune, 1973. Prof. Gadgil even suggested that States' plan outlays may be determined by the Finance Commissions.
6. Gulati I.S. and George K.K., op.cit.
7. Government of Kerala, *Economic Review*, 1977, 1996, and 1997 Trivandrum.
8. George.K.K. , "Economic Reforms: What They Foretell Different States?," Paper presented at the Seminar on Disparities and Equality, Institute of Social Change and Development, Guwahati, 1996.

**TABLE VI-1**  
**Annual Growth Rates in Plan Expenditure**

Year	(In Percentage)		
	Revenue Plan	Capital Plan	Total Plan
1975-76	49.7	32.1	38.1
1976-77	49.6	24.2	33.6
1977-78	19.7	32.4	27.2
1978-79	36.3	5.1	17.2
1979-80	-3.5	42.1	21.4
1980-81	63.3	7.9	27.8
1981-82	1.2	14.5	8.4
1982-83	-5.1	-10.6	-8.3
1983-84	62.8	59.7	61.1
1984-85	9.4	-4.4	1.8
1985-86	-5.9	13.5	4.1
1986-87	10.0	21.0	16.2
1987-88	17.6	-14.5	-1.2
1988-89	23.8	-6.4	8.4
1989-90	-0.8	43.0	18.5
1990-91	23.2	2.2	12.1
1991-92	4.5	11.8	8.0
1992-93	29.4	-9.9	9.7
1993-94	18.7	47.1	30.4
1994-95	20.9	20.4	20.6
1995-96	20.9	13.8	17.6
1996-97RE	49.5	21.1	36.8
1997-98BE	49.3	0.6	30.0

**Notes and References:**

1. Unlike the Plan Outlays given in Table VI.2, Plan Expenditure here includes only the expenditure financed through the state budgets. It excludes the expenditure of the State Public Sector units financed by their internal resources and non-budgetary borrowings.
2. Includes the expenditure under Central and Centrally Sponsored Schemes.

Source : Based on "Finances of State Governments" R.B.I. Bulletin, Various issues.

**TABLE VI-2**  
**State Plan Outlays (1956-1997)**

State	(Rupees Per Capita)									
	II	III	APs	IV	V	AP	VI	VII	1990-92	VIII
	1	2	3	4	5	6	7	8	9	10
1. Punjab	88	118	102	316	694	199	1396	2597	1014	3327
2. Maharashtra	67	109	103	199	518	161	1294	2139	697	3372
3. Haryana	88	118	96	357	669	202	1563	2501	786	3169
4. Gujarat	90	115	101	204	515	171	1453	1992	869	2930
5. Karnataka	72	106	76	128	355	109	910	1310	616	2718
6. West Bengal	59	86	47	82	278	86	549	979	302	1292
7. Kerala	58	107	83	154	310	105	771	1021	427	2310
8. All States	58	95	70	141	360	113	893	1557	496	1935

Sources:

1. For Col.1-6, George.K.K , *Centre State Financial Flows and Inter State Disparities*.
2. Based on data on Plan outlays of States,R.B..I. Bulletin.
3. States ranked according to per-capita state domestic product.

**Table VI-3**  
**Share of Central Plan Transfers in Total Plan Expenditure**

Plan Periods	(In percentages)	
	Kerala	All States
V	67.7	53.8
1979-80	49.0	48.7
VI	46.9	53.2
VII	70.0	56.0
1990-92	63.2	57.6
VIII	38.4	43.6



**TABLE.VI-4**  
**Non-Plan Revenue Surpluses under the Awards of the Finance Commissions**  
 (Rupees per Capita)

States	Finance Commissions									
	IV 1	V 2	VI 3	VII 4	VIII 5	IX 6	IX 7	X 8		
Punjab	27	87	252	579 (38.5)	1048 (51.1)	201	468	875		
Haryana	-	80	223	676 (38.7)	1079 (45.9)	206	1454	3649		
Maharashtra	55	83	149	596 (46.3)	1021 (60.5)	345	1389	3076		
Gujarat	4	60	126	423 (28.4)	719 (39.8)	128	767	2489		
West Bengal	4	-	-	153 (30.7)	-39 (-10)	37	-9	602		
Karnataka	-	-	79	343 (34.3)	556 (55.3)	32	792	3128		
Tamil Nadu	-	-	45	159 (15.5)	665 (54.8)	111	523	1668		
<b>Kerala</b>	-	-	-	<b>112 (12.4)</b>	<b>245 (27.1)</b>	<b>35</b>	<b>-162</b>	<b>1172</b>		
Andhra Pradesh	-	-	-	217 (24.3)	356 (33.2)	48	417	274		
Rajasthan	-	-	-	85 (3.7)	-6 (40.6)	-	-280	677		
Orissa	-	-	-	15 (-3.2)	-39 (-2.4)	-	-210	1		
Uttar Pradesh	2	32	-	233 (29.5)	343 (33.4)	73	-260	214		
Madhya Pradesh	-	4	27	282 (27.4)	38 (26.2)	54	-60	1248		
Bihar	19	35	-	205 (33.8)	120 (14.6)	138	24	214		

Note : 1 Figures in brackets under columns 4 and 5 indicate overall surplus (revenue plus capital) after devolution, grants and debt relief as percentage of the Sixth and the Seventh Plan Outlays.

- Sources : 1. For Columns 1-5, George K.K., *Centre -State Financial Flows and Inter-State Disparities*, Criterion Books, Delhi, 1988, p. 89  
 2. For figures in brackets, see George K.K., and Gulati I.S., "Eight Finance Commission's Award". Economic and political Weekly, Bombay, July 25, 1987.  
 3. For column 6, George K.K. "Ninth Finance Commission's First Award", *Economic and Political Weekly*, April 1, 1989.  
 4. For column 7, *Second Report of the Ninth Finance Commission*, Dec. 1989, P. 32.  
 5. For column 8, *Report of the Tenth Finance Commission*.

## CHAPTER VII

### **KERALA MODEL: FISCAL IMPLICATIONS AND DEVELOPMENT OPTIONS**

The slow growth in economy and fiscal crisis reinforcing each other have been setting limits to the Kerala model of development. The State today is unable to spend adequately not only on Economic Services, but also on Social and Community Services. As a result, the State's lead even in social services is gradually being undermined. For instance, Kerala's first position in per capita expenditure on Social Services has now been taken over by Punjab and Tamil Nadu though they spend only a much lower percentage of its revenue on these services.<sup>1</sup> Both Rajasthan and Punjab have overtaken Kerala in the matter of per capita expenditure on health.<sup>2</sup> In expenditure on education, Kerala is overtaken by Punjab though the latter spends only 2.6 per cent of its sdp on education as against 6.9 per cent by Kerala. Though the State was a pioneer in implementing social security schemes, its capacity to continue its lead is threatened by fiscal disabilities. The number of unemployed has been increasing in the State; but the amount disbursed for unemployment relief has not been increasing correspondingly.<sup>3</sup> The public distribution system which covers 97 per cent of the households and has been widely acclaimed as a model is threatened by State's incapacity to bear the burden of growing subsidies.

State's fiscal debility has eroded its capacity not only for undertaking new projects, but also for servicing completed past projects. Its inability to utilise fully the capacities which it has built up in the past plan periods leads to waste in public expenditure. Attempts are frequently made to impose blanket cuts on non-plan expenditure with a view to carve out some balances on current account to finance the State Plans of at least minimum size. These attempts have very often led to waste of many earlier Plan Schemes. Excessive

control of non-plan expenditure leads to non-maintenance of capital assets created in the earlier plans. This also leaves many earlier schemes without sufficient funds for current inputs. This results in the deterioration in quality of public services. Since the employees working in non-plan schemes cannot be dispensed with at the end of each plan period, whatever fund remaining after cuts are often sufficient only to meet the establishment expenditure. This may possibly be one of the reasons why the share of compensation for employees in Final Outlay is quite high in the state as was seen in Chapter V. This may be a major reason why the numerous non-plan schemes languish with very little 'work content'. This situation prevails in other States also. But it is more acute in Kerala in view of the higher share of Social and Community Services whose recurring component in expenditure is generally much more than in Economic Services.

### **Second Generation Problems**

The success of Kerala Model in its wake has induced a large number and variety of problems with fiscal and development implications to the State. Some of Kerala's achievements are comparable to those of advanced countries. But these have also brought in its wake some of the advanced countries' problems. The State does not have the fiscal ability to tackle them all by itself. Since these problems are unique to the State, they have not received the national attention and priorities which they deserve.

### **Can Kerala Afford to Grow Old?<sup>4</sup>**

We had seen earlier how Kerala's success in prolonging life expectancy has been burdening it with a high volume of service pension payments. The problem is likely to get aggravated in future as death rates fall further in the State among old people. It is estimated that average expectation of life of persons above the age of 60 is likely to go up from 16.5 during 1981-85 to 21 during 2021-25. The expectation of life even at the age of 80 is likely to go up from 5.4 to 7.6.<sup>5</sup> This changing demographic profile of the State is bound to increase the burden of State's exchequer not only on account of service pensions to government employees, but also on account of old age pensions.

One of the reasons often cited for the State's fiscal crisis is the prevalence of social security schemes. Majority of these schemes is targeted at the aged persons. The burden of these schemes is likely to increase in view of the demographic changes taking place. The aged dependency ratio in the State has increased steadily from 11.3 per cent in 1961 to 13.2 per cent in 1981. This ratio is projected to go up to 30.9 per cent in 2026.<sup>6</sup>

In view of the State's a unemployment problem, it is likely that a working person has to carry not only the aged and the young, but also the unemployed relatives in the working age group. This puts tremendous strain on family finances and the State is called upon to share at least a part of this burden by giving unemployment doles to the young and social security pensions to the aged. In doing this, the State is only trying to mitigate some of the second generation problems arising out of the State's attainments in the field of health care and education. The problem of dependency of the aged on their families or the government becomes all the more acute in Kerala in view of the fast declining work participation rates among the aged. In fact, work participation rates of males above 60 came down to 43.4 in 1981 from 60.1 in 1971. These rates were much lower in Kerala than in the country (63.7 in 1981).<sup>7</sup> These lower rates may partly be the consequence of the higher wage rates prevalent in the State which discourage old persons being employed.

In case the resource base does not expand substantially in the near future, the capacity of the State to shoulder this strain on account of its senior citizens will become increasingly limited. The welfare system has come under severe strain already. The rates of welfare payments are not raised in time to compensate for the increases in cost of living. Besides, these payments are effected only after considerable time lags.

In view of the grim prospect of higher demand for social security including those for service pensions, the State may have to rethink the design and administration of pension schemes. Instead of disbursing pensions directly from the revenue budget, the State may possibly have to think of establishing social security trust funds, which



will be contributed by both employees and employers. If these trust funds are invested soundly, it will not pose a threat to the state exchequer. If these funds are utilised for expanding the capital stock in the State, the future generations will not have to shoulder the whole burden of pensions.<sup>8</sup>

### **Can Kerala's Health Status be Maintained?**

The changing demographic profile is also likely to increase the demand for expenditure on health services. For instance, the increasing proportion of aged in the total population of the State has changed the disease profile of the State. According to Panikar and Soman, a new category of diseases comprising degenerative and neoplastic diseases like hypertension, cardio vascular diseases and cancer have begun to emerge in the State.<sup>9</sup> The proportion of these diseases which is already quite high is likely to increase further. These diseases of the old call for higher investment in diagnostic equipments, hospitalisation, treatment, recovery and rehabilitation.

At a time when the expenditure requirements on health are rising, the State is finding it increasingly difficult as also unwilling to meet these requirements. Instead of increasing the share of medical and public health services in total expenditure, the State has been reducing its share progressively in recent plan periods as seen in Chapter V. Rates of growth in real per capita expenditure came down from 5.26 per cent between 1974-75 and 1984-85 to 1.36 between 1985-86 and 1991-92.<sup>10</sup> No doubt, the State has built up an impressive infrastructure in terms of hospitals and medical personnel. But it is not able to supply other inputs to patients. After meeting the compensation for employees, it is able to spare only very little for meeting other consumption requirements on goods and services. This is indicated in Table VII-I. The Table shows that the share of goods and services in the consumption expenditure on health services has been steadily coming down from 1982-83. It is also not able to make further capital investments. This has led to decrease in the role of government sector in health services. The number of beds in the State sector increased from 36000 to 38000 between 1986 and 1996. The bed strength in the private hospitals increased from 49000 to 67500 during this



period.<sup>11</sup> As a result, preference for private medical care has been increasing in the State. This has been boosting the average private expenditure on medical care. Such expenditure now forms about 7 per cent of per capita income.<sup>12</sup>

### **Can Kerala Afford to Cut its Expenditure on Education?**

In recent years, avowedly due to fiscal crisis, the State government has been reducing its expenditure on education. The share of education in total expenditure has been brought down from 27.4 per cent during the Fifth Plan to 21.9 per cent during the Eighth plan. The Share of education in Plan expenditure has come down still more drastically, from an already low 10.6 per cent to 6.2 per cent. As a result, rates of growth in real per capita expenditure on education came down from 3.18 per cent during the period 1974-1985 to 1.11 per cent during the period 1985-1992. Both these rates are the lowest among 15 major states.<sup>13</sup>

No doubt, there has been some reduction in the number of students, partly as a result of the decline in birth rates, creating excess capacity in some schools and rendering some schools uneconomic.<sup>14</sup> This phenomenon, as also the State's relatively high quantitative achievements in the realm of literacy and general education has lent some credence to the policy of reduction in State's expenditure on education. But the case for reducing the share of education does not appear to be strong on closer analysis. A fact that is often overlooked is that the past quantitative expansion in education has been at the cost of quality. Many of the educational institutions lack adequate facilities. This is indicated indirectly by the high share of employees' compensation in the total consumption expenditure on education (93.4 per cent in 1990-91 - See Table V-22). This share has also been increasing. The high share of salaries bill and pensions in expenditure on education indicates lower availability of funds for other educational inputs. The share of goods and services consumed, which was already very low, has been coming down still further in recent years (See Table VII-1). In fact, the share of goods and services consumed in education was only 6.6 per cent against 16.3 per cent in general public services. Kerala thus provides an example of capital investments in the social sectors rendered ineffective by failure to provide for current

spending on essential inputs. The low increments in capital investments also affect the quality of education. The share of capital expenditure in total expenditure on education was only 1.8 per cent during the Eighth Plan. (See Table V-8)

One of the important reasons for the emergence of excess capacity in many state run and state aided schools, apart from the decline in number of children, is the proliferation of unaided, English medium schools, not only in cities but also in small towns. This phenomenon is largely a result of the decline in standards in the state run and state aided schools. In a state where parents consider their children's education as the best available form of investment, possibly due to the absence of other better avenues, this trend towards better quality education outside the state system cannot be reversed, except by improving the quality of education in the state run and the state aided schools. This is bound to cost the exchequer considerably more. In terms of the State's direct expenditure per student, Kerala today ranks the second lowest among states, second only to Bihar.<sup>15</sup>

Higher education as well as technical education are two areas which are neglected in the State. University and college education has received relatively small share in the educational budget of the State though there has been marginal improvement in its share in the eighties. In 1993-94, the share of higher education was only 14.8 per cent of the budget for education. Expenditure on technical education has formed only 3.8 per cent of the total budget on education. In fact, this share has declined from 4.2 per cent 1980-81.

It is true that as compared to many other states, the number of students going for higher education in the State is quite high. But in relation to the number of students passing out of the schools, facilities for higher education in the state even in quantitative terms are inadequate. This demand for tertiary enrolment is yet another advanced countries' problem inherited by the poor state of Kerala. The number of students enrolled in higher education and research in the State formed only 13.1 per cent of the total number of students enrolled in secondary and Higher Secondary Schools. In this respect, Kerala is placed in the lowest category of states.<sup>16</sup> As a result of



inadequate opportunities, even students with high academic achievements are unable to get admission for courses of their choice. Those who can afford, manage to get admission in private colleges in neighbouring states after paying heavy capitation and other fees. The poor are denied opportunities to pursue higher education. As a result, social mobility through education which characterised the earlier phase of Kerala's development is getting undermined.<sup>17</sup>

Declining standards is yet another problem in the field of State's higher education. There is a number of circumstantial evidences to prove this. This trend tends to make the products of Kerala's universities and colleges not only unemployed but also unemployable. Since the State's economy depends to a large extent on manpower exports, the decline in quality of these 'exports' affects the economy. Thus, it also accentuates the State's unemployment problem.

The emphasis in Kerala till now has been on general education at school, college and university levels. Kerala's colleges, universities and technical educational institutions still lay emphasis on traditional courses offering traditional degrees. Knowledge explosion taking place in science, technology and management and the trend of increasing specialisation have not influenced, to any large extent, the higher education system in the State. In the past, Kerala, unconsciously perhaps, had been attuning its educational system to the changing requirements of job markets elsewhere. But now, the capacity of Kerala's formal educational system to respond to the qualitative changes taking place in the job markets in India as also abroad has come down. The present rapid changes in job markets elsewhere call for attainment of more modern knowledge and skills. This calls for starting non-traditional, more specialised courses in newly emerging areas. All these call for higher investment per student. But unfortunately, the State is reducing the share of education in its expenditure avowedly due to fiscal constraints, precisely at this juncture.

It is sometimes argued that Kerala's past priorities in favour of social services, at the expense of economic services, have led to its present low economic growth. The increasing popularity of this view has made it easier for the State government to reduce progressively

the importance of education in its budget. This view under-estimates the role played by education in sustaining economic activity in the State at least at its present level. For instance, higher educational status of the State played an important role in controlling population growth with all its beneficial consequences. There is also a connection between education and the migrant remittances which had been sustaining Kerala's economic activity in recent years. These are some of the indirect economic returns on Kerala's expenditure on education. The State may be taking a major risk in changing its expenditure priorities as it has been doing for quite some time. The State may lose whatever advantage it has already got while the gains on the economic front may be uncertain, given the All-India policy framework in which the State's economy operates.

It appears that Kerala Government is moving out of step of other State Governments in India who are now, increasing the share of social services in their budgets. It is also deviating from the trend of governments elsewhere in the world who now concentrate more on provision of social services rather than on economic services, leaving the latter increasingly to the market.

It is a moot question whether the funds spent in the past on education and health, had they been diverted for other directly productive activities, would have resulted in larger economic growth and generation of employment. It is quite possible that diversion of funds from social services particularly education, even if it can be achieved, (it is difficult, given the unsatisfied demand for educational and health facilities) may not be sufficient to generate adequate infrastructural and industrial investments in the State. According to an old study by the State Planning Board, an investment of Rs.25,300 crores is required if the State's per capita income is to reach the national average. This is clearly beyond the State's means. As compared to the availability of investment funds with Central government, All-India financial institutions and the capital market, the funds for industrial investment that can be generated by a state government by saving on educational or medical expenditure can only be too meagre. It is also possible to take a view that the shortage of investment funds may not be the principal reason for Kerala lagging behind in economic



growth, particularly in industrial growth. The plan priorities of Central government, the absence of a regional framework in national plans, absence of regional dimension to Central government policies, especially industrial policy, inadequate Central government investments, etc. may perhaps be the more important factors retarding the State's development. There are of course other non-economic factors too.<sup>18</sup>

In the present discussion on Kerala's fiscal and development crises, a choice is often presented between expenditure on social services, and economic development. But this appears to be a false choice. Social development and economic development need not necessarily be mutually exclusive especially in today's world where human capital has become the most important form of capital. The economies are increasingly becoming knowledge driven. It may be possible for the State to increasingly transform its expenditure on education and health from a mere social welfare expenditure into an investment in human capital. Fruits of Kerala's past expenditure on social services, particularly education can be reaped only if the State can conceive of a new strategy of development based on its human resources. Instead of cursing the past pattern of development as anti growth and trying to replicate the growth pattern of other states for which it has got only limited raw material and fuel resources, it may be possible for the State to build its economy on its educated man power resource. Instead of trying to catch up with other States in 'modern' industries, the State must seek to be a pioneer in the 'Post modern', skill and knowledge intensive industries and services. This calls for not reduction, but further investment in human resource development, both for exports and for the state's own labour market. This is the only way in which Kerala's future plans for economic growth can be integrated with its past achievements in social services, brought about at huge cost to its exchequer. What is called for is a Kerala model of economic growth.



## Notes and References

1. Government of Kerala. *Kerala Budget in Brief*, 1996-97 Trivandrum.
2. Ibid.
3. Government of Kerala, *Economic Review 1997*, Trivandrum.
4. This is the title of a book by Aaron J Henry, *Can America Afford to Grow Old? - Paying for Social Security*, The Brooking Institution, Washington D.C., 1989
5. Gulati Leela and Rajan Irudaya, "Population Aspect of Aging in Kerala, Their Economic and Social Context", Working paper, Centre for Development Studies, Trivandrum, 1991.
6. Ibid.
7. Ibid.
8. Aaron J. Henry - op. cit.
9. See Panikar P.G.K. and Soman C.R *Health Status of Kerala*- Centre for Development Studies, Trivandrum, 1985.
10. Prabhu Seetha K and Chaterjee Somanath, *Social Sector Expenditure and Human Development: A Study of Indian States*, Reserve Bank of India, Bombay, 1993 quoted in "Social Indicators: Inter State Disparities", *EPW* May, 21, 1994.
11. Quoted in *The Hindu*, Trivandrum, May 24, 1998.
12. See Panikar P.G.K., "High Cost of Medical Care in Kerala", *Economic and Political Weekly* June 6, 1992.
13. Prabhu Seetha K and Chaterjee Somanath, op. cit.
14. In 1996-97, there were 1407 uneconomic schools in the State, See, *Economic Review 1997*.
15. Raza, Moonis et. al., 1984, "Higher Education in India", quoted by Oommen, M.A., *Development Expenditure, Development Priorities and Fiscal Resources of Kerala*, Centre of Science and Technology for Rural Development, Trichur.
16. Annual Report 1997-98, Ministry of Human Development, Department of Education, Government of India, New Delhi, 1998.

17. See (1) George.K.K. *Financial Crisis in Kerala's Higher Education: Causes and Policy Options*, Vichara (Mavelikara, Kerala) 1995, (2) *Entry Barriers to Professional Education in Kerala*, 'Centre for Socio Economic and Environmental Studies,' Cochin, 1998.
18. George.K.K. "Historical Roots of Kerala Model and Its present Crisis", *Bulletein of Concerned Asian Scholars*, California, Oct. 1998.

TABLE VII-1

Share of Individual Services in Total Consumption Expenditure of Kerala (In Percentage)											
Services	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91
1. Gen. Public Services	25.7	26.0	21.6	21.3	21.3	20.9	19.0	18.8	15.9	17.8	16.3
2. Soc. & Comm. Services	21.9	24.1	24.1	20.8	19.2	17.6	19.4	15.6	14.9	17.0	18.4
Of which											
(a) Education	14.6	11.9	10.2	10.1	9.5	9.1	10.2	8.0	7.2	10.2	6.6
(b) Health	37.9	38.4	53.0	34.7	33.7	29.1	27.8	26.5	26.6	26.9	24.5
3. Economic Services	63.3	58.0	53.0	54.9	44.2	46.7	46.8	41.5	46.6	43.1	39.2

## CHAPTER VIII

### CONCLUSION

Our analysis shows that the Kerala Model of Development has almost reached the end of its tether. The paradoxical phenomenon of rapid social development unaccompanied by corresponding gains in economic growth has been exhausting itself. As the Human Development Report (1992) of the United Nations Development Programme observed, "Human Development offers a much broader and more inclusive perspective. It demonstrates that economic growth is vital; no society has in the long run been able to sustain the welfare of its people without continuous injections of economic growth".<sup>1</sup>

The current experience of Kerala is nothing unique. There are comparable international experiences. For instance, Costa Rica which developed a welfare state financed partly by borrowings like Kerala had come to grief by the eighties.<sup>2</sup> Many of the welfare states of Europe are also facing crisis as a result of fiscal imbalances, slow growth in their economies, rising unemployment and aging population. All these countries are in the process of redesigning their welfare states.

Kerala's fiscal crisis which has been setting the limit to Kerala Model of Development, is almost built into the very model of development, and the pattern of financing the expanded government. At least from the eighties, Kerala had been financing a good portion of its social welfare expenditure by borrowing at high rates of interest. The superstructure of an expanding welfare state was built on the shaky foundations of an economy marked by low productivity gains and low rates of growth. Though the State's resource mobilisation efforts had been better than that of many other states, it has been limited by the slow expansion of its resource base. Besides, the State had been following a resource mobilisation strategy inappropriate

for the structure of its economy as also its pattern of public expenditure. The State was basically relying on taxation, particularly commodity taxation, neglecting non-tax revenues for resource mobilisation. This strategy is not appropriate to an economy where service sectors had been growing much faster than the commodity producing sectors. This is also found unsuitable for recovering at least a part of the government's cost on these services. Besides, the State which had assumed a direct entrepreneurial role failed to generate adequate returns on its investment. All these investments have now become a big drain on the State's budget. Besides, the revenue administration also leaves much to be desired.

On the expenditure side, it undertook full responsibility for meeting almost the total expenditure on education, even though most of the institutions are in the non-governmental sector. As a result, teaching grants to private educational institutions form 34.8 per cent of the salary bill of the state. Similarly, it undertook the responsibility of subsidising most of the public distribution system and almost the whole of the educational system, irrespective of the economic status of the beneficiaries. Subsidies, both hidden and open, were provided to the users of almost all government services, unmindful of government's eroding fiscal capacity. No attempt was made for pruning the bureaucracy and improving its productivity. There is a crying need for redesigning the government. More attention has to be given to improved or alternate methods and instruments of delivering public services. The recent attempt to decentralise government by strengthening the local level institutions is a step in the right direction. But this is only one of the several steps to be taken. There is also need for redefining the role of the state. This has become essential in the changed national and global context. The world over, there have been serious attempts to delineate more clearly the responsibilities of the public and private sectors. There has been substantial refocusing on core government functions. Such a refocusing has become inevitable in the context of the Kerala's grave fiscal crisis. This becomes unavoidable if the Kerala model is to be saved from a fiscal breakdown. It is now neither possible nor desirable to push up the proportion of public expenditure to state domestic



product. The historical context when state's role had to expand not only in social sectors but also in economic sectors no longer exists. The State's entrepreneurial role has to give way for a facilitator's role.

The failure of the Central funding agencies to appreciate the fiscal implications of the Kerala model had been equally disastrous for the State's fiscal health. The larger recurring expenditure needs of social services as compared to economic services and their implications to the State's budgets have been rarely understood by agencies like the Finance Commission and the Planning Commission. The bigger impact of increase in cost of living on the State's exchequer on account of its higher bill for compensation for employees, implicit in the larger proportion of its expenditure on social services, has also not been fully understood by these agencies. In fact, Kerala is now penalised by the Central funding agencies for its attainments in social development. At the same time, they had not shown due consideration for its economic backwardness and for its special problems like the educated unemployment. These agencies had also failed to appreciate the expenditure requirements for tackling some of the second generation problems induced by Kerala's very success in social development. Some of these expenditure like social security pensions and unemployment relief are met by federal governments in other federations, while in India, States are forced to fend for themselves. Central government's direct expenditure in the state too had been coming down over a long period.

While Centre - State financial flows to the State had been inadequate, some of the Central Government's policies, have curtailed state's taxing powers. The legislation restricting states' power to tax export commodities and the failure to permit imposition of consignment tax affect a state like Kerala more adversely as a larger proportion of its domestic production is sold in the national and international markets.

While all the factors discussed above are important, the roots of Kerala's fiscal crisis lie in the failure of its economy to grow corresponding to its social development. In a number of countries,

increase in social development, particularly literacy and enrolment in primary schools are associated with increase in gross domestic product. In Kerala, on the other hand, growth in state domestic product decelerated while literacy improved steadily. How come that Kerala's social development, particularly its universal literacy and higher educational levels have not triggered off the growth process which would have averted the fiscal crisis and sustained its social development? This is a larger question which has not been addressed to in the present study. As a first step in this direction, it may be necessary to reformulate Kerala model as a paradox of deceleration in economic growth despite social development and not the other way as is currently formulated.

Some of the answers to the above question may lie at least partly with the highly centralised federal system, which had prevented the State from reaping the full benefits of its human development. For instance, one of the major economic benefits of Kerala's human development had been the large inflow of foreign remittances sent by the migrants from Kerala. Paradoxically, however, Kerala economy's growth slackened precisely when the inflow of remittances gathered momentum. In the highly centralised economic system, Kerala had not been able to appropriate for itself the full benefits of these remittances. It cannot bring these remittances under its direct tax net as the power to tax income and wealth rests with the Centre. Under the system of centralised management of foreign exchange, Kerala had to conform to Central government's priorities if it were to utilise this scarce resource for its own economic development. In fact, due to the consistently over valued exchange rate of rupee till the nineties, the State had not been receiving even the market value of these migrant remittances.<sup>3</sup> While all other exports have been receiving direct and indirect subsidies, Kerala's exports of manpower have not been getting any subsidy. (This is also applicable to Kerala's merchandise exports).<sup>4</sup> On the contrary, as seen earlier, flow of funds to maintain, modernise and expand Kerala's educational sector has been reduced in recent years due to inadequate appreciation of the national interest, leave alone State's interest, served by this sector.

State's disability to appropriate fully the fruits of its human development is not confined to foreign exchange resources earned by its educated manpower. It also extends to rupee resources. Many studies have noted the outflow of rupee funds earned by Kerala's migrants through the commercial banking channels and through the capital markets.<sup>5</sup> The credit deposit ratio in the State has been coming down steadily. Today, it is as low as 43 per cent.

The entire blame for Kerala's economic deceleration despite its human resource development cannot be placed on the Central government. Nor can this phenomenon be explained fully in economic terms. There are strong non- economic reasons also.<sup>6</sup> It appears that the focus of human development in the State was more on distribution, rather than on generation of income. The principal concern appears to have been social rather than developmental. The State has not been able to conceive its expenditure on social services as an investment rather than as a welfare measure. If the State has to reap the full benefits of its expenditure on social services, it has to formulate a new strategy of economic growth based on its human resource development which calls for continuous upgradation of its social service sectors, particularly its educational sector. Only such a growth strategy will be appropriate for the Kerala Model of Development.

## Notes and References

1. United Nations Development Programme, *Human Development Report- 1992*, New York.
2. See, Silvia Lara, *Inside Costa Rica*, Resource Centre Press, New Mexico, 1995.
3. See, Thottathil P "The internal transfer of income from exporters to importers within a foreign exchange control regime: an Indian case" *Applied Economics*, (London) Sept. 1988.
4. Ibid.
5. See George K.K, *Centre State Financial Flows and Inter-State Disparities*, Criterion Books, Delhi 1988. About 44 per cent of bank deposits in the State come from non-residents.
6. See George.K.K. "Historical Roots of Kerala Model and its present Crisis" *Bulletin of Concerned Asian Scholars*, California, Oct. 1998.



The Kerala Model of development has been receiving favourable attention, both national and international. But within the State, doubts regarding the sustainability of the Model are being aired increasingly in the wake of Kerala's acute fiscal and economic crisis. The present study is an attempt to examine the structural and systemic relationship between the Kerala Model and the State's fiscal crisis. The study also discusses the implications of the fiscal crisis for the State's development process.

**Dr. K.K.George** is currently Director of the School of Management Studies, Cochin University of Science and Technology. Before joining the University, Prof. George was working with the State Bank of India. He has done considerable work in the area of Federal Finance. His current research interests are in Kerala's development process and its educational system.

Rs. 160/-



**Centre for Development Studies  
Thiruvananthapuram**